

This is a digital copy of a book that was preserved for generations on library shelves before it was carefully scanned by Google as part of a project to make the world's books discoverable online.

It has survived long enough for the copyright to expire and the book to enter the public domain. A public domain book is one that was never subject to copyright or whose legal copyright term has expired. Whether a book is in the public domain may vary country to country. Public domain books are our gateways to the past, representing a wealth of history, culture and knowledge that's often difficult to discover.

Marks, notations and other marginalia present in the original volume will appear in this file - a reminder of this book's long journey from the publisher to a library and finally to you.

Usage guidelines

Google is proud to partner with libraries to digitize public domain materials and make them widely accessible. Public domain books belong to the public and we are merely their custodians. Nevertheless, this work is expensive, so in order to keep providing this resource, we have taken steps to prevent abuse by commercial parties, including placing technical restrictions on automated querying.

We also ask that you:

+ *Make non-commercial use of the files* We designed Google Book Search for use by individuals, and we request that you use these files for personal, non-commercial purposes.

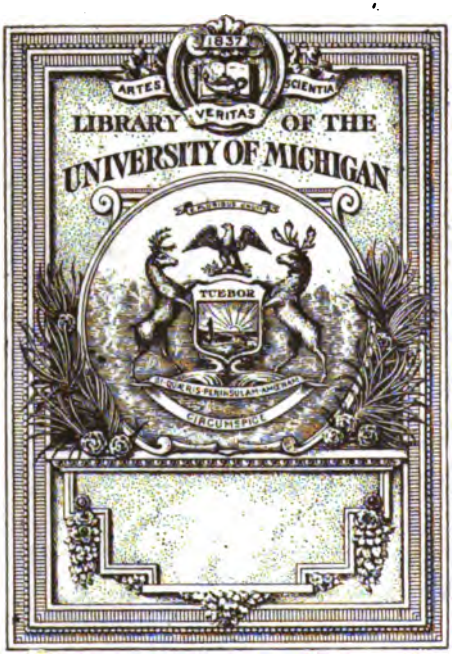
+ *Refrain from automated querying* Do not send automated queries of any sort to Google's system: If you are conducting research on machine translation, optical character recognition or other areas where access to a large amount of text is helpful, please contact us. We encourage the use of public domain materials for these purposes and may be able to help.

+ *Maintain attribution* The Google "watermark" you see on each file is essential for informing people about this project and helping them find additional materials through Google Book Search. Please do not remove it.

+ *Keep it legal* Whatever your use, remember that you are responsible for ensuring that what you are doing is legal. Do not assume that just because we believe a book is in the public domain for users in the United States, that the work is also in the public domain for users in other countries. Whether a book is still in copyright varies from country to country, and we can't offer guidance on whether any specific use of any specific book is allowed. Please do not assume that a book's appearance in Google Book Search means it can be used in any manner anywhere in the world. Copyright infringement liability can be quite severe.

About Google Book Search

Google's mission is to organize the world's information and to make it universally accessible and useful. Google Book Search helps readers discover the world's books while helping authors and publishers reach new audiences. You can search through the full text of this book on the web at `http://books.google.com/`


1837
ARTES
VERITAS
SCIENTIA
LIBRARY OF THE
UNIVERSITY OF MICHIGAN
TUEBOR
CIRCUMSPICE

HJ
465
.N43
1918

INCOME TAX LAW AND ACCOUNTING



THE MACMILLAN COMPANY
NEW YORK · BOSTON · CHICAGO · DALLAS
ATLANTA · SAN FRANCISCO

MACMILLAN & CO., LIMITED
LONDON · BOMBAY · CALCUTTA
MELBOURNE

THE MACMILLAN CO. OF CANADA, LTD.
TORONTO

INCOME TAX
LAW AND ACCOUNTING
1918

BEING

A PRACTICAL APPLICATION OF THE PROVISIONS OF THE FEDERAL INCOME TAX ACT OF SEPTEMBER 8, 1916, AS AMENDED; THE WAR INCOME TAX AND THE WAR EXCESS PROFITS TAX LAWS OF OCTOBER 3, 1917; AND

CONTAINING

THE CORPORATION CAPITAL STOCK TAX LAW AND RULINGS THEREON; FEDERAL ESTATE TAX, EXCISE AND MISCELLANEOUS WAR TAXES; AND THE NEW YORK STATE INCOME TAX STATUTE APPLICABLE TO MANUFACTURING AND MERCANTILE CORPORATIONS

BY

GODFREY N. NELSON

MEMBER OF THE NEW YORK BAR
CERTIFIED PUBLIC ACCOUNTANT, STATE OF NEW YORK

SECOND EDITION

New York
THE MACMILLAN COMPANY
1918

All rights reserved

Copyright, 1917,
By GODFREY N. NELSON.

Copyright, 1918,
By THE MACMILLAN COMPANY.

Set up and electrotyped. Published January, 1918.
Reprinted February, 1918.

Norwood Press
Berwick & Smith Co., Norwood, Mass., U.S.A.

PREFACE TO SECOND EDITION

The numerous commendatory reports upon the first edition of this book and the requests, by those who used it, for one covering the new laws, have impelled the author to write the present revised and enlarged edition. By reason of the material amendments of the Income Tax Act of September 8, 1916, and the enactment of the War Income and the War Excess Profits Taxes, contained in the War Revenue Bill of October 3, 1917, all of which are treated herein, have necessitated the rewriting of the greater part of the book so that the present edition is, practically, an entirely new work. The original scheme of arrangement, however, has been largely adhered to with the view of making the book a practical guide to those required to prepared returns either for themselves or others.

All Treasury Decisions issued to date, bearing upon the Excess Profits Tax Law, have been incorporated herein either in the text or in foot-notes. From time to time additional decisions and regulations will be issued by the Treasury Department "as occasion demands," copies of which may be obtained upon application to the local collectors or to the Commissioner of Internal Revenue at Washington. Many problems arising under the Excess Profits Tax Law will not be ruled upon by the Department until applications for rulings are formally presented. In the absence of specific rulings the writer has suggested interpretations of the law, particularly with respect to methods of computing invested capital. In such matters as the writer has ventured his construction of the law the suggestions contained herein should be used in conjunction with the decisions and regulations that will be promulgated by the Department. The Department should be consulted freely and unhesitatingly and questions of importance should be submitted for special rulings. Such questions form the basis of decisions and rulings and the solution of your problems may help many others who encounter the same difficulties.

Time has not permitted the rewriting of some paragraphs

affected by very recent decisions but notes have been appended in connection therewith in order to apprise the reader of the latest rulings, and the text of such decisions have been added to Chapter V on the Excess Profits Tax.

Professional contact with the officials and officers of Internal Revenue of the Treasury Department at Washington, including the Commissioner, himself, and with such members of the Advisory Board as the writer has had the pleasure of meeting, has impressed him with their profound and unanimous desire to grant to the taxpayer every right and fair concession possible to be drawn from a most liberal interpretation of the law that will ensure an equitable administration of it. With this significant assurance, *not inconsistent with a positive duty*, the taxpayer should dismiss from his mind that sense of antagonism that so often exists toward tax departments of the Government, and should seek to coöperate with them for the procurement of the necessary revenue of which the present extraordinary taxes are expected to contribute a vital part.

The writer wishes to express his gratitude to those of his friends who by suggestions and helpful recommendations and counsel have made possible the treatment of a variety of problems that will present themselves under the new laws; he also takes occasion to express his grateful acknowledgment of the helpfulness of the Income and War Tax Services of the Corporation Trust Company, which contain the rulings and decisions of the Treasury Department upon these laws.

On account of the difficulty of arrangement, the subjects are not coördinately grouped. The index, however, has been made especially copious in order to afford a ready reference to the subject of inquiry.

GODFREY N. NELSON.

52 Broadway, New York City,
January 2, 1918.

PREFACE TO FIRST EDITION

Since the enactment of the Corporation Excise Tax of 1909, and the Federal Income Tax Law, applicable to both individuals and corporations, effective March 1, 1913, the writer has prepared, and advised with regard to, many income tax returns of corporations and individuals. The preparation of returns almost invariably necessitated the analysis and subdivision of book accounts as commonly kept in order to conform them to the classification prescribed by these laws. To obviate the necessity of analyzing and rearranging accounts and to facilitate the preparation of returns was the first thought that actuated the writing of this book. To make it more helpful there have been included rulings of the Treasury Department and court decisions on the most important items of income and expenses.

The writer makes no pretense at having produced a law book and at no time had that aim in view. This is intended merely to serve the purpose of a practical guide to those who, either for themselves or others, are called upon to prepare returns. Statements contained herein are predicated: first, upon the Income Tax Law enacted September 8, 1916, which was retroactive and took effect as of January 1, 1916; second, upon rulings by the Treasury Department thereon; and third, upon such rulings and court decisions under the Excise Tax of 1909 and the Income Tax Law of 1913, which are consistent and not in conflict with the requirements of the present law.

An expression of gratitude is due to various officials and officers of Internal Revenue of the Treasury Department at Washington and New York for the courtesies shown to the writer in matters submitted to them, but this acknowledgment should not be construed as an endorsement by them of the contents of this book. The writer also acknowledges the helpfulness of the Income Tax Service of the Corporation Trust Company, the index to which was especially useful as a ready

reference to Treasury Decisions. Mention should also be made of Mr. Henry Campbell Black's treatise on the law of "Income Taxation" under Federal and State laws, to which the writer has referred.

The arrangement of subjects is not co-ordinate throughout, but the order of the statute and the returns of net income have been followed as nearly as practicable.

GODFREY N. NELSON.

52 Broadway, New York City,
December 16th, 1916.

TABLE OF CONTENTS

I. INCOME TAX AS APPLIED TO INDIVIDUALS

PAGE

I. General Provisions of Law: Income Tax—War Income Tax—War Excess Profits Tax—When Effective..... 1

II. Income Tax (Act of Sept. 8, 1916): Who is subject to Income Tax—Division of Tax—Normal—Additional—Dividends—Exemptions..... 2

III. War Income Tax (Act of Oct. 3, 1917): Who is subject to War Income Tax—Division of Tax—Normal—Additional—Dividends—Exemptions..... 3

IV. Income and War Income Taxes: Exemptions—Combined Normal Taxes—Combined Additional Taxes—Examples of Computing Normal Taxes—Examples of Computing Normal and Additional Taxes—Table of Normal and Additional Taxes on Incomes of $2,000 to $3,000,000.....4–11

V. Returns of Individuals: Combined Return—Who is Required to make return—Return Form—Return by Husband and Wife—Fiduciaries—Agent—Private Banks—Citizen residing abroad—To whom Return is made—Verification—Returns by persons in Military Service—Due date of filing—Extension of Time—Penalty for Failure to file Return—False Return—When Internal Revenue Officer may prepare Return—Due date of Payment—Penalty, delayed Payment—*Claims for Refund of Taxes—Advance Instalment Payments—Forms of Payment—Porto Rico, Philippines.....11–19

VI. Income of Individuals: Income Defined—Undivided Surplus of Corporations—Dividends, Life Insurance Policies—Principal, Life Insurance Policies—Accident Insurance—Damages, Injuries—Dividends—Dividends earned prior to March 1, 1913—Stock Dividends—Payable in Securities—Paid out of Reserves—Purchases and Sales of Stock—Exchange of Stock—Stock received in Reorganization—Sale of Stock Rights—Scrip Dividends—Dividends Received from Foreign Corporations—Return of Capital, not Income—Profits of Limited Partnerships—Salaries, when Returnable—Salary paid by Stock—Salary received of Exempt Corporation—Living Quarters,

PAGE

part of Compensation—Board, Lodging, etc., in lieu of Cash—Bonuses—Salesmen's Commissions—Professional Fees, when Returnable—Clergymen—Compensation of Trustees—Profit on Sales of Capital Assets—Profit or Loss on Securities acquired prior to March 1, 1913—Profit Defined—Sales of Real Estate—Cost of Property—Appreciation not Income—Promissory Notes—Gifts, Legacies—Income of Estates—Heirs and Legatees—Legacies, Vested Interest—Profit returnable by Legatee—Trust Estate undistributed for Period of Years—Insurance Agents—Rentals Received—Interest, Government Obligations — Political Subdivision — Contractor Working for State—Liberty Bonds, 3½%—4%—Income and Expenses of Government Employees—Rates of Exchange—Foreign Investments—Interest, Bank Account—Pensions—Alimony—License required by Collectors of Foreign Income—Foreign Income, Non-Resident Aliens—Record Owner not Actual Owner of Stock.....19–48

VII. Farms and Farmers: "Farms and Farmers," Defined—Income from Farms—Prepaid Farm Expenses—Shares—Expenses—Losses — Live Stock — Farm Machinery — Depreciation — Books of Account—Farm maintained only for Recreation....48–50

VIII. Deductions Allowed Individuals: Exemptions—Single—Married—Heads of Families—Salaries Exempt—Dividends Creditable—Tax Withheld—Necessary Business Expenses—Interest Deductible—Interest Incurred in Purchase of Liberty Bonds—Accrued Interest on Bonds Purchased—Charities—Taxes—Local Assessments — Water Rates — Pensions—Premium, Fidelity Bonds—Loss Defined—Loss not in Business or Trade—Losses, more than one Trade—In Trade Defined—Bad Debts—Depreciation—Stocks and Bonds—Depletion, Oil and Gas Wells—Mines—Improvements—Restoring Property—Replaced Buildings—Condemned Buildings—Damage Suits, Judgments—Insurance Reserve Funds—Insurance Premiums—Commissions, Real Estate—Campaign Expenses—Expense, Nontaxable Income—Assessment of Stocks—Taxes paid by Tenant—Life Insurance Premiums—Inheritance Tax—Taxes on Bank Stock.....51–59

II. WITHHOLDING TAX

Amended Law—Nonresident Alien Individuals—Nonresident Foreign Corporations—Dividends to Nonresident Alien Com-

PAGE

panies—Tax—Exempt Clause—Exemption—Returns of Taxes Withheld—Indemnity of Withholding Party—Release of Taxes Withheld—Information at Source—Interest on Bonds—Aliens, Permanent Residents—Temporary Residence in the United States—Residence, defined—Visiting Alien—Wife Assumes Nationality of Husband—Stock Dividends, Nonresident Corporations.....60–67

III. INCOME TAX AS APPLIED TO PARTNERSHIPS

IX. General Partnerships: Partnerships taxable Individually only—Returns—Fiscal Year—Dividends Received by Partnerships—Method of Accounting—Income, when Accrued—Premiums Life Insurance Policies—Credits on Individual Returns of Partners—Partnership Expenses.....68–70

X. Limited Partnerships: Special Partners—Profits of Limited Partnerships.....70–71

IV. INCOME TAXES APPLICABLE TO CORPORATIONS

XI. General Provisions: Domestic Corporations—Foreign Corporations—Rates—Exemptions—Foreign Income—Excess Profits Tax—Undistributed Surplus Tax—Dividends.....72–75

XII. Returns of Corporations: Form of Return—Return of Domestic Corporation—Foreign Corporation—Due Date—When last Day falls on Sunday or Holiday—Signatures and Oath of Officers—When Tax Payable—Delayed Payment, Penalty—Fiscal Year—Designating Fiscal Year—Apportioning Income 1917—When Tax Payable Under Fiscal Year—Extension of Time—Failure to File—False or Fraudulent Return—Refusal or Neglect to File—Return by Department—Second Assessment—Recovery of Payment—Publicity—Corporation Incompletely Organized—Existing Corporations—Corporations Maintaining Foreign Branches—Holding Companies—Subsidiary Companies—Receivers, Trustees, Assignees—Corporations Organized During Tax Year—Corporation in Liquidation—Liability of Dissolved Corporation—Interstate Commerce Corporations—Foreign Corporations Represented by Agents—Having Branches in U. S.....75–84

XIII. Exempt Organizations: List of all Classes of Corporations and Organizations Exempt—Required to Withhold—Exempt Foreign Organizations—Not Organized for Profit—Corporations

PAGE

Controlled by Exempt Organizations—Organized for Profit—Water Company.....84–89

XIV. Income of Corporations: Net Income—Gross Income: Manufacturing Corporations—Mercantile—Miscellaneous—Contracting—All Sources—Insurance Companies—Banks—Mutual Companies—Dividends—Profit, Sales of Capital Assets—Acquired Prior to March 1, 1913—Interest, Sinking Funds—Assessment of Paid-up Capital Stock—Exchange of Stocks and Bonds, Reorganization, Real Estate Development Corporation—When Cost includes Carrying Charges—Instalment Business—Timber Lands, Stumpage.....89–100

XV. Deductions Allowed Corporations: Expenses—Losses—When Deductible—Property Acquired Prior to March 1, 1913—Depreciation—Depletion, Oil and Gas Wells, Mines—Maintenance, defined—Renewals—Improvements—Bad Debts—Reserve for Bad Debts—Reserve, Insurance Companies—Contingent Reserve—Suspense—Sinking Fund—Discounts on Sales—Interest, Limitation—Interest incurred in Purchase of Liberty Bonds (4%)—Interest on Indebtedness Secured by Collateral—Interest, Preferred Stock—Bonds of Corporations—Amortization of Discount on Bonds—Premiums on Bonds Purchased—Loss in Retirement of Bonds at Premium—Discount on Bonds—Life Insurance Premiums Paid by Corporation—Taxes—Local Benefits—Taxes paid by Tenant—Salaries of National Guardsmen—Pensions—Salesmen's Expenses—Service Connections, Water Company—Payments to Government—Defalcations—Organization Expenses—Campaign Expenses—Insurance Companies—Assessment Insurance Companies—Deductions Allowed Foreign Corporations.....100–115

V. WAR EXCESS PROFITS TAX

War Measure—Administration—Who is Subject to Tax—Exempt Organizations—Principle of Tax Deductions—Exemptions—Incidence of Tax—Duration—Old Tax Repealed—Rates of Taxes Where Capital is Employed—Rate of Tax—Nominal Capital—Taxable Year—Prewar Period—Returns of Citizens—Resident Aliens—Domestic Corporations—Returns of Nonresident Aliens and Foreign Corporations—Returns of Domestic Partnership—Returns of Foreign Partnerships—Due date of filing Returns—Taxes, Partnerships—Inequity in case of Foreign Partnerships—Returns of Net Income for

PAGE

Prewar Period and Taxable Year of Corporations—Limited Partnerships—Net Income for Prewar Period and Taxable Year of Individuals and Partnerships—Occupation, Salary—Land Owner Income—Mines, Oil Wells, Timber Lands—Income from Investments—Invested Capital of Taxable Year—Exclusions from Invested Capital—Invested Capital of Partnership or Corporation—Value of Tangible Property, Partnerships or Corporations—Patents, Copyrights, Partnership or Corporation—Invested Capital of Individuals—Invested Capital of Foreign Corporation or Partnership or Nonresident Alien—Liberty Bonds—Invested Capital of Corporations and Partnerships—Invested Capital, Books of Account—Where Invested Capital cannot be Determined—Partial Change of Ownership—Reorganized or New Corporation—Good Will, Trade-marks, Franchises—Reserve Accounts, Reserve Funds—Deductions to Citizens, Domestic Corporations and Partnerships—Deductions to Foreign Corporations and Partnerships, Nonresident Aliens—Corporation or Partnership not in Existence and Individual not in Trade in Prewar Period—Where Business Yielded no Net Income or Comparatively Low Net Income—Subnormal Profits—How to Obtain Benefit of Deduction Based on Income of Representative Concerns—Salaries of Partners—When Deductible—Wages of Members of Farmer's Family not Deductible—Administration of Law—Application of Law to Real and Nominal Capital—Revaluation of Property—Notes on Items Contained in Examples of Computing Invested Capital: Cash on Hand and in Banks—Accounts Receivable—Bills Receivable—Stock on Hand—Investments, Plant and Machinery—Furniture and Fixtures—Land—Buildings—Deferred Assets, Prepayments—Liabilities—Accounts Payable—Bills Payable—Accrued Liabilities—Bonds Payable—Dividends Declared—Reserve for Amortization of Bonds—Reserve for Contingencies—Reserve for Equalizing Dividends—Capital Stock—Surplus—Invested Capital—Suggestions in Connection with the Valuation of Assets for Purposes of Invested Capital: Organization Expenses—Subscriptions to Capital Stock—Treasury Stock—Unexecuted Contracts—Patents—Trade-marks—Franchise—Patterns and Designs—Plates and Dies—Treasury Decisions under the Excess Profits Tax: Inventories of Merchandise, etc., and Securities held by Dealers—Tangible and Intangible Property Defined—Salary Allowance to Partnerships and In-

PAGE

dividuals—Profits Derived by Partners from Partnerships—Interest on Loans by Partners—Return, Prewar Period—Bonds as Invested Capital—Limitation of Value of Property as at Jan. 1, 1914.....116–174

VI. DEPRECIATION

Depreciation Deductible from Income—Methods of Computing Depreciation—Reserve for Depreciation—Diverting Reserves—Rates of Depreciation—Buildings—Building Repairs—Additions—Betterments—Additions to Leased Property—Buildings Erected by Tenants—Furniture and Fixtures—Dwellings—Farm Buildings—Depletion of Mines—Leased Mines on Royalty—Depletion of Oil and Gas Wells—Leased Oil and Gas Territory—Machinery—Boilers, Engines—Repairs, Replacements—Shafting—Tools—Miscellaneous Equipment—Laundry Equipment—Copyrights—Auto Trucks—Horses—Stable Equipment—Good Will—Investments—Stocks and Bonds—Theatrical Costumes—Trade-marks—Brands, Stock on Hand—Munitions Works, War Materials—Ships—Various Trades and Businesses based on Allowances in England: Boots; Brewers; Collieries; Dyers; Engineers; Hosiery; Lace Making; Looms; Newspaper and Printing; Sewing Machines; Tramways; Weaving.....175–195

VII. BOOKKEEPING SUGGESTIONS

Preparation of Income Tax Returns of Corporations: Method of Bookkeeping—Books of Account Best Guide to Income—Examination of Books by Internal Revenue Officers—Accruals—Prepayments—Distribution of Accounts—Sales—Return Sales—Allowances—Discounts Allowed—Discounts Received—Rebates—Freight on Sales—Freight on Purchases—Inventories—Rentals—Royalties—Interest Received—Interest Paid—Debenture Bonds—Dividends Received—Income from Sundry Sources—Labor, Wages and Commissions—Fuel, Light, Power, etc.—Repairs, Ordinary and Incidental—Salaries of Officers—Sundry Expense Accounts—Customs, Duties—Loss by Fire—Sales of Capital Assets—Depreciation—Depletion—Ledger Entry of Depletion of Property—Taxes—Capital Stock—Interest bearing Indebtedness—Merchandise Account—Profit and Loss Account—Dividends Declared—

PAGE

Reconciliation of Return with Books of Account—Manufacturing Corporations Operating Cost-System—Inventory Equivalent—Materials and Supplies Used.....196–218

APPENDIX A. Federal Income Tax Law Enacted September 8, 1916, as amended by the Acts of March 3, 1917, and October 3, 1917.....219–248

APPENDIX B. War Revenue Law Enacted October 3, 1917.....249–284

APPENDIX C. Federal Corporation Capital Stock Tax Law Enacted September 8, 1916.....285–304

APPENDIX D. Special Excise Tax on Corporations Enacted August 5, 1909 (Repealed by Act of October 3, 1913).....305–311

APPENDIX E. Extracts From Federal Income Tax Law Relating to Corporations, Enacted October 3, 1913 (Repealed by Act of September 8, 1916).....312–319

APPENDIX F. Table of Additional Taxes (Surtaxes) Imposed Upon Individuals by Income Tax of 1913..... 320

APPENDIX G. New York State Income Tax on Manufacturing and Mercantile Corporations, Enacted June 4, 1917...321–330

TABLE OF CASES..... 331

INDEX..... 333

A
tic
It
Law
Pract
ne
In
is o
char
icie
to p
tion
A
law
or t
plic
tax
aid
que
I
em
law
tic
fea
lib
Ta
the
of
be
tra
po
to
in

INTRODUCTION

A just and fair application of income tax laws presents many difficult problems.

Law and Practice.

It is unreasonable to expect that an income tax statute, or even regulations thereon, could work equitably as applied to all cases; what proves to be fairness in one case may result in hardship in another.

Income taxation in the United States—as a permanency—is of comparatively new development. The Department in charge of its administration has proved itself eminently efficient. The present staff and régime, however, are inadequate to provide for a system of hearings and of passing upon questions of practice and procedure in cases requiring rulings.

A thoroughly successful and equitable administration of the law cannot be attained until there is provided some local board or tribunal to pass upon propositions in which a technical application of the law or regulations would work injustice to the taxpayer. This is accomplished in Great Britain through the aid of "District" or "General" Commissioners who pass upon questions of procedure and accounting.

It is noteworthy that writers on the English Income Tax emphasize the flexibility of the practice as compared with the law. Mr. William Sanders, in the second edition of "The Practice and Law of Income Tax" (1916) states: "An outstanding feature of the Income Tax is that the practice is much more liberal than the law." Again, he says: "The law of Income Tax is, in many respects, harsh and inequitable, but much of the prevailing hardship may be mitigated by an application of the practice in its existent broadness. It should, however, be taken as a general principle in connection with the administration of the tax, that practically all desired and accepted points of equity which clash with the law, are never offered to the public but have to be demanded." Mr. W. E. Snelling in the second edition of his "Excess Profits Duty" states: "It

is hardly too much to suggest that, in important respects in this connection, the Act necessarily does little more than indicate the general direction which should be followed in the computation of taxable excess. Within limits, the Legislature invites applications for the modification of general rules which peculiar circumstances render inequitable. The discretionary powers accorded to the taxing authority are similarly noteworthy."

As in England, there cannot be a fair and equitable administration of income taxes in the United States, without the exercise of a reasonable degree of liberality in the practice by those under whose authority the law is administered. Until such time as local boards will have been established (the necessity for which now appears imperative) application for special rulings should be made to the Commissioner of Internal Revenue either at Washington, D. C., or through the local collector.

The Secretary of the Treasury has just announced the appointment of a "Commission of Nine Advisers" to interpret the Excess Profits Tax Law, which Commission, it is intimated, will also have judicial functions. This is a step in the right direction and it is hoped that further provision will be made throughout the States for a system of hearings upon questions that have already been propounded in connection with war tax measures.

TERMS USED HEREIN

AS DEFINED BY INCOME TAX LAWS, DECISIONS AND RULINGS THEREUNDER, OR AS CONSTRUED FROM THEIR ORDINARY USAGE

ABATEMENT is a claim for allowance or refund of taxes.

"ACCRUAL BASIS" refers to method of account keeping and manner of making return. A return prepared on that basis includes income and expenses accrued as well as those received and disbursed.

ADDITIONAL TAXES OR SURTAXES are the graduated or progressive taxes imposed upon individuals by the Acts of September 8, 1916, and October 3, 1917, designated as the Income Tax and War Income Taxes, in addition to the Normal Tax imposed thereby. In effect, the Excess Profits Taxes on individuals and corporations, are also additional taxes based upon income.

ADDITIONS, BETTERMENTS AND IMPROVEMENTS are items of expense that add to the value of property, *i. e.*, capital expenditures.

ALIEN. An alien is a citizen or subject of a country other than the United States. (See "Resident Alien" and "Non-resident Alien.")

AMORTIZATION refers to the redemption of a liability, as the amortization of bonds; or the reduction of an asset by means of a sinking fund or otherwise.

ASSET, refers to property such as stock-in-trade, cash, accounts receivable, land, buildings, machinery, tools, stocks, bonds, good will, and so on. Some of these are limited or excluded as invested capital.

AVERAGE PREWAR PROFIT refers to the amount deductible in ascertaining the sum subject to the Excess Profits Tax; it is based upon profits earned during the designated prewar years, 1911, 1912 and 1913, and, by limitation of law, the rate cannot exceed 9 per cent. or be less than 7 per cent. of capital invested for the taxable year.

BAD DEBTS are accounts or bills receivable that are uncollectible, or only partly recoverable and bad debts as to the uncollectible part.

BALANCE SHEET is a statement of assets and liabilities as at a particular time.

BONDED INDEBTEDNESS is a corporate obligation secured by a bond.

BONUS refers either to additional compensation paid for services rendered or to a gratuity. The circumstances of each case will determine its treatment for income tax purposes.

CAPITAL EMPLOYED is defined as the entire capital paid in by stockholders, plus so much of the accumulated surplus as is not in excess of the needs of the business, but excludes any borrowed capital or indebtedness.

CAPITAL INVESTED or INVESTED CAPITAL cannot be briefly defined. (See page 128.)

CORPORATION, under the Income Tax Acts, includes joint-stock companies or associations and insurance companies.

DEDUCTIONS are the items of expense, losses sustained and allowances by law permitted to be deducted from income or profit in ascertaining the taxable amount; also, exemptions to which the taxpayer is entitled by provision of law.

DEPLETION is the reduction in value of natural resources deductible in the ascertainment of net income.

DEPRECIATION is the shrinkage in value of tangible property occasioned by use, deterioration, wear and tear, etc.

DIVIDEND is a sum distributed or ordered to be distributed among the stockholders of a corporation out of its earnings; the term is used to denote the entire amount distributed or ordered to be distributed, as well as the portion received or receivable by a stockholder.

DOMESTIC CORPORATION is one "created under the laws of the United States, or of any State, Territory or District thereof." (Section 200, Excess Profits Tax Law.)

EXCESS PROFITS TAX is a tax imposed upon corporations, partnerships and individuals in addition to the Income Tax and War Income Tax.

EXEMPT ORGANIZATIONS are only those that are, by classes, specifically enumerated in the law.

FISCAL YEAR is the annual period for which a corporation or partnership makes its accounting, usually fixed, respectively, by the by-laws or articles of copartnership. In the case of an individual, with respect to returns under present income tax laws, it can only be the calendar year.

FOREIGN CORPORATION is one created under the law of any possession of the United States other than a State, Territory or District thereof, or of any foreign country or government. (Section 200, Excess Profits Tax Law.)

GOOD WILL is the value that attaches to a business beyond its tangible property, by reason of reputation or location. Under the Excess Profits Tax good will may, where it was purchased for cash or property, be a part of the "capital invested" with limitation as to amount.

GROSS INCOME OR GROSS PROFIT is usually the excess of proceeds of sale of commodities dealt in over the cost of goods sold, plus income from other sources, without any deduction in respect of administration or distribution expenses.

HEAD OF FAMILY is held to be "a person who actually supports and maintains one or more individuals who are closely connected with him by blood relationship, relationship by marriage or by adoption and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation." (T. D. 2427).

"INFORMATION AT SOURCE" refers to returns to be made in place of withholding at source as heretofore. Except in respect of payments to nonresident alien individuals and nonresident alien corporations, and payments of interest to citizens and resident aliens on obligations containing a tax free covenant clause, taxes need not now be withheld at the source of payment.

"IN TRADE," as defined by the Treasury Department, is synonymous with business, employment, regular occupation.

LIABILITY is an obligation or indebtedness.

LIMITED PARTNERSHIP is a partnership that has one or more "special partners" whose liability is limited; it is formed by complying with State laws providing therefor. In the application of income tax laws it is treated as a corporation.

NET INCOME, NET PROFIT or NET EARNINGS is the excess of gross income or gross profit over and above the sum of deductible expenses and losses allowed by law as deductions. As applied to foreign corporations or partnerships or a non-resident alien individual, it refers only to net income received from sources within the United States.

NONRESIDENT ALIEN is a citizen or subject of a country other than the United States whose domicile is without the United States.

NORMAL TAXES, in the case of individuals, are the flat rates or taxes computed on the net income, less dividends of corporations whose net income is subject to tax, tax withheld at the source and personal exemptions. In the case of corporations, the normal taxes are those imposed upon the entire net income as determined by provision of law. For the purpose of normal tax no exemption is allowed to corporations. All normal taxes are flat rates—not progressive.

OCCUPATION, as used in the Excess Profits Tax, by ruling of the Treasury Department, includes employment, compensated for by a salary. Persons receiving a salary are subject to the flat rate of the Excess Profits Tax.

PARTNERSHIP is not defined in either of the present Income Tax Acts. In a liberal sense, it is the relation which exists "between persons carrying on a business in common with a view of profit." (See pages 68 to 71.)

PREWAR PERIOD, as used in the Excess Profits Tax, refers to years 1911, 1912 and 1913 or such of these years, during the whole of which, a corporation or copartnership was in existence or an individual was engaged in trade or business.

PROFIT AND LOSS ACCOUNT is a statement of the profit or loss of an undertaking for a given period of time.

RATES, refer to rates or percentages of taxes.

REG. (Treasury Regulation) refers to rules and regulations prescribed by the Treasury Department.

REORGANIZATION is "A term applied to the formation of a new corporation by the creditors and shareholders of a corporation which is in financial difficulties, for the purpose of

purchasing the company's works and other property, after the foreclosure of a mortgage or judicial sale." (34 Cyc. 1336.)

RESERVE denotes an amount set aside from profits for a particular purpose or to meet contingencies. (See Reserve Account and Reserve Fund.)

RESERVE ACCOUNT represents an amount charged to Profit and Loss (deducted from profit) in determining the true or net profit. Comparatively, such an account is a *fictitious* reserve in that it is usually a reduction of the book value of the asset (property account) to which it relates. (See "Reserve for Depreciation.")

RESERVE FUND represents an amount set aside from profits and segregated in the assets or set apart from other assets; for example, cash deposited in a separate bank account or invested in outside securities. Comparatively, a reserve fund is a *real* reserve in that it is actually set apart from other property.

RESERVE FOR DEPRECIATION is an account that represents the amount of depreciation of property deducted from profits. It is a *fictitious* reserve in that it is merely the measures by which the asset account (property account) has been reduced by depreciation charged off.

"RESIDENCE" or "PLACE OF RESIDENCE" is one's permanent home or domicile as distinguished from lodging or temporary abode.

RESIDENT ALIEN is a citizen or subject of a country other than the United States whose domicile is within the United States.

"RETURN" is a report of net income prepared in the form prescribed by law.

SALARY refers to compensation paid for services rendered; the amount is fixed in advance, at a sum certain, for a definite period of time.

SURPLUS or SURPLUS PROFITS is the excess of assets over and above the sum of liabilities and capital. It may or may not include reserves, according to the nature of them.

SURTAXES or SUPERTAXES are the taxes imposed upon individuals under the Acts of September 8, 1916, and Oc-

tober 3, 1917, in addition to the normal tax. (See "Additional Taxes.")

TAX FREE COVENANT CLAUSE is a contract or provision in a bond by which the obligor agrees to pay the tax on the income from such bond or part thereof imposed upon the obligee, whereby the obligor agrees to reimburse the obligee therefor.

T. D. (Treasury Decision) designates a ruling under, or interpretation of, the law by the Treasury Department, which has the effect of law.

TRADE and BUSINESS, under the Excess Profits Tax, include professions and occupations.

UNDIVIDED PROFITS of a corporation refer to the difference between the net earnings and dividends paid or declared therefrom.

UNITED STATES "means only the States, the Territories of Alaska and Hawaii and the District of Columbia." (Section 200, Excess Profits Tax.)

WITHHOLDING AT SOURCE refers to the deduction of the normal tax by the payer of income and paying the same to the Government officials authorized to receive the same.

WITHHOLDING AGENT is one who is required to withhold the normal tax from the income of another of which he has the custody or disposal.

INCOME TAX LAW AND ACCOUNTING

CHAPTER I

TAXES APPLICABLE TO INDIVIDUALS

I. General Provisions of Law

The Federal Income Tax Law, enacted September 8, 1916, as amended, by Act of October 3, 1917, comprises the present Income Tax Law. **Income Tax, 1918.**

In addition to the present income taxes, the Act of October 3, 1917, imposes upon citizens and residents of the United States a War Income Tax which is computed upon the same net income as that upon which the Income Tax is levied, but with different amounts of exemptions, an additional normal tax, and at different rates of surtaxes. **War Income Tax.**

The Act of October 3, 1917, provides, also, for the imposition of a War Excess Profits Tax upon net income, less a deduction. (See page 116.) **War Excess Profits Tax.**

All of the aforementioned taxes are applicable to income of the entire year 1917; the amendments to the Income Tax Law of September 8, 1916, the War Income Tax and the War Excess Profits Tax, enacted October 3, 1917, are retroactive and effective as of January 1, 1917. **When Effective.**

II. Income Tax (Act of September 8, 1916)

Every citizen of the United States, irrespective of his place of residence, at home or abroad, and every resident of the United States, shall pay the tax upon his entire net income received from all sources, in the preceding calendar year; and every nonresident alien shall pay the tax upon his entire net income received from all sources within the United States; less the credits and exemptions to which such persons shall, respectively, be entitled under the law. **Who is Subject to Income Tax.**

Division of Tax. The tax on the income of individuals is composed of two parts, designated the "normal tax" and the "additional tax," or "surtax."

Normal Tax. The normal tax imposes the fixed annual rate of 2 per cent. upon the entire net income of individuals, except,

1. Income derived from dividends on the capital stock or net earnings of corporations, joint-stock companies or associations, or insurance companies, on which the normal tax is paid by such companies or associations;

Dividends.

2. The personal exemption of $3,000 per annum to an unmarried person and $1,000 additional to a head of a family,[1] or to a married man with a wife living with him, or to a married woman with a husband living with her, provided, however, that only one $4,000 shall be allowed to both husband and wife from their aggregate income. (A nonresident alien is not allowed a personal exemption);

Personal Exemptions.

3. An additional exemption of $200 to the head of a family (allowable only to one parent of the same family) for each dependent child under the age of eighteen years, or if incapable of self-support by reason of being mentally or physically defective regardless of age.

Additional Tax. The additional tax is imposed upon all net income of the individual, including that received as dividends on capital stock or from net earnings of corporations, joint-stock companies or associations, or insurance companies, in excess of $20,000, upon the progressive scale, as follows:

On amounts in excess of:									
$20,000	and not in excess of					$40,000	1	per	cent.
40,000	"	"	"	"	"	60,000	2	"	"
60,000	"	"	"	"	"	80,000	3	"	"
80,000	"	"	"	"	"	100,000	4	"	"
100,000	"	"	"	"	"	150,000	5	"	"
150,000	"	"	"	"	"	200,000	6	"	"
200,000	"	"	"	"	"	250,000	7	"	"
250,000	"	"	"	"	"	300,000	8	"	"

[1] A head of a family is "a person who actually supports and maintains one or more individuals who are closely connected with him by blood relationship, by marriage or by adoption, and whose rights to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation." T. D. 2427.

$300,000	and not in excess of	500,000	.....	9	per	cent.
500,000	"	"	"	"	"	1,000,000	.....	10	"	"
1,000,000	"	"	"	"	"	1,500,000	.....	11	"	"
1,500,000	"	"	"	"	"	2,000,000	.....	12	"	"
2,000,000	.....	13	"	"

III. War Income Tax (Act of October 3, 1917)

Every citizen of the United States, irrespective of his place of residence, at home or abroad, and every resident of the United States, shall pay the tax upon his net income received from all sources in the preceding calendar year, less the credits and exemptions to which such person shall, by law, be entitled. **Who is Subject to War Income Tax.**

The War Income Tax law is not applicable to nonresident aliens.

The War Income Tax, as in the case of the Income Tax, is divided into two parts, the normal and the additional tax. **Division of Tax.**

The normal war income tax is fixed at the flat rate of 2 per cent. upon the entire net income of individuals, except: **Normal Tax.**

1. Income derived from dividends on the capital stock or net earnings or corporations, joint-stock companies or associations, or insurance companies, on which the normal tax is paid by such companies or associations; **Dividends.**

2. The personal exemption of $1,000 per annum to the unmarried person and $2,000 to the head of a family or to a married man with a wife living with him, or to a married woman with a husband living with her; provided, however, that only one deduction of $2,000 shall be allowed to both husband and wife from their aggregate incomes; **Personal Exemptions.**

3. An additional exemption of $200 to the head of a family (allowable only to one parent of the same family) for each dependent child under the age of eighteen years, or if incapable of self-support, because mentally or physically defective.

The additional tax under the War Income Tax Law is imposed against the entire net income of individuals, including that received as dividends on capital stock or from net earnings of corporations, joint-stock companies **Additional Tax.**

or associations, or insurance companies, in excess of $5,000 upon a graduated scale, as follows:

On amounts in excess of:									
$5,000	and not in excess of					$7,500	1	per	cent.
7,500	"	"	"	"	"	10,000	2	"	"
10,000	"	"	"	"	"	12,500	3	"	"
12,500	"	"	"	"	"	15,000	4	"	"
15,000	"	"	"	"	"	20,000	5	"	"
20,000	"	"	"	"	"	40,000	7	"	"
40,000	"	"	"	"	"	60,000	10	"	"
60,000	"	"	"	"	"	80,000	14	"	"
80,000	"	"	"	"	"	100,000	18	"	"
100,000	"	"	"	"	"	150,000	22	"	"
150,000	"	"	"	"	"	200,000	25	"	"
200,000	"	"	"	"	"	250,000	30	"	"
250,000	"	"	"	"	"	300,000	34	"	"
300,000	"	"	"	"	"	500,000	37	"	"
500,000	"	"	"	"	"	750,000	40	"	"
750,000	"	"	"	"	"	1,000,000	45	"	"
In excess of $1,000,000							50	"	"

IV. Income Tax and War Income Taxes

COMBINED RATES AND EXAMPLES OF THEIR APPLICATION TO INCOMES

Exemptions. Under the combined administration of both Acts, hereinbefore mentioned, all persons will receive credit for the exemptions to which they are, respectively, entitled under each Act, as follows:

	Act of Sept. 8, 1916	*Act of Oct. 3, 1917*
Unmarried person	$3,000.00	$1,000.00
Married person or head of family	4,000.00	2,000.00

Combined Normal Taxes. The normal tax under each of the Acts is 2 per cent., making a total normal tax of 4 per cent. upon the entire net income, less the respective exemptions, and, under the combined administration of both Acts the normal taxes are, in the case of,

Unmarried persons:

Two per cent. on amounts in excess of $1,000 and not in excess of $3,000.

Four per cent. on amounts in excess of $3,000.

Married persons or heads of families:

Two per cent. on amounts in excess of $2,000 and not in excess of $4,000.

Four per cent. on amounts in excess of $4,000.

The combined additional taxes under both Acts are as follows:

Combined Additional Taxes.

		Act of Sept. 8, 1916	*Act of Oct. 3, 1917*	*Total Rates*
		Per Cent.	*Per Cent.*	*Per Cent.*
On amounts in excess of:				
$5,000	and not in excess of $7,500	none	1	1
7,500	" " " " " 10,000	none	2	2
10,000	" " " " " 12,500	none	3	3
12,500	" " " " " 15,000	none	4	4
15,000	" " " " " 20,000	none	5	5
20,000	" " " " " 40,000	1	7	8
40,000	" " " " " 60,000	2	10	12
60,000	" " " " " 80,000	3	14	17
80,000	" " " " " 100,000	4	18	22
100,000	" " " " " 150,000	5	22	27
150,000	" " " " " 200,000	6	25	31
200,000	" " " " " 250,000	7	30	37
250,000	" " " " " 300,000	8	34	42
300,000	" " " " " 500,000	9	37	46
500,000	" " " " " 750,000	10	40	50
750,000	" " " " " 1,000,000	10	45	55
1,000,000	" " " " " 1,500,000	11	50	61
1,500,000	" " " " " 2,000,000	12	50	62
2,000,000	.....	13	50	63

The following examples illustrate the method of computing the normal and additional taxes imposed by the Income Tax, as amended, and the War Income Tax, enacted respectively, September 8, 1916, and October 3, 1917.

EXAMPLE OF COMPUTING THE NORMAL TAX OF AN UNMARRIED PERSON WITH A NET ANNUAL INCOME OF $5,000

Net Taxable Income		$5,000.00
Personal exemption		1,000.00
Subject to Normal Tax		$4,000.00
As follows:		
2% of (amount over $1,000 and not over $3,000) $2,000	$40.00	
4% of (amount over $3,000 and not over $5,000) $2,000	80.00	
Amount subject to tax. $4,000		
Total Tax		$ 120.00
Or, otherwise stated:		
2% of ($5,000 less exemption of $3,000) $2,000	$40.00	
2% of ($5,000 less exemption of $1,000) $4,000	80.00	
Total Tax		$ 120.00

EXAMPLE OF COMPUTING THE NORMAL TAX OF A MARRIED PERSON WITH A NET ANNUAL INCOME OF $5,000

Net Taxable Income		$5,000.00
Personal exemption		2,000.00
Subject to Normal Tax		$3,000.00
As follows:		
2% of (amount over $2,000 and not over $4,000) $2,000	$40.00	
4% of (amount over $4,000 and not over $5,000) $1,000	40.00	
Amount subject to tax....$3,000		
Total Tax		$ 80.00
Or otherwise stated:		
2% of ($5,000 less exemption of $4,000) $1,000	$20.00	
2% of ($5,000 less exemption of $2,000) $3,000	$60.00	
Total Tax		$ 80.00

EXAMPLE OF COMPUTING NORMAL AND ADDITIONAL TAXES OF AN UNMARRIED PERSON WITH A NET ANNUAL INCOME OF $25,000

Net Taxable Income		$25,000.00
Normal Tax:		
2% of (amount in excess of $1,000 and not in excess of $3,000) $2,000	$ 40.00	
4% of (amount in excess of $3,000 and not in excess of $25,000) $22,000	880.00	
Subject to Normal Tax $24,000		
Normal Tax		$ 920.00
Or, otherwise stated:		
2% of ($25,000 less exemption of $3,000) $22,000	$440.00	
2% of ($25,000 less exemption of $1,000) $24,000	480.00	
Normal Tax	$920.00	

ADDITIONAL TAX (COMBINED)

On amount in excess of:				
$5,000 and not in excess of	$7,500	= $2,500 @ 1%,	$25.00	
7,500 " " " "	10,000	= 2,500 @ 2%,	50.00	
10,000 " " " "	12,500	= 2,500 @ 3%,	75.00	
12,500 " " " "	15,000	= 2,500 @ 4%,	100.00	
15,000 " " " "	20,000	= 5,000 @ 5%,	250.00	
20,000 " " " "	25,000	= 5,000 @ 8%,	400.00	
Additional or Surtax				$ 900.00
Total Tax				$ 1,820.00

EXAMPLE OF COMPUTING NORMAL AND ADDITIONAL TAXES OF A MARRIED PERSON WITH A NET ANNUAL INCOME OF $50,000

Net Taxable Income		$50,000.00
Normal Tax:		
2% of (amount in excess of $2,000 and not in excess of $4,000) $2,000	$ 40.00	
4% of (amount in excess of $4,000 and not in excess of $50,000) $46,000	1,840.00	
Subject to Normal Tax $48,000		

Normal Tax	$ 1,880.00
Or, otherwise stated:	
2% of ($50,000 less exemption of $4,000) $46,000..	$ 920.00
2% of ($50,000 less exemption of $2,000) $48,000..	960.00
Normal Tax	$1,880.00

ADDITIONAL TAX (COMBINED)

On amount in excess of:					
$5,000	and not in excess of	$7,500	= $2,500 @	1%,	$25.00
7,500	" "	10,000	= 2,500 @	2%,	50.00
10,000	" "	12,500	= 2,500 @	3%,	75.00
12,500	" "	15,000	= 2,500 @	4%,	100.00
15,000	" "	20,000	= 5,000 @	5%,	250.00
20,000	" "	40,000	= 20,000 @	8%,	1,600.00
40,000	" "	50,000	= 10,000 @	12%,	1,200.00

Amount subject to surtax $45,000	
Additional or Surtax	$ 3,300.00
Total Tax	$ 5,180.00

EXAMPLE OF COMPUTING NORMAL AND ADDITIONAL TAXES WHERE INCOME INCLUDES TAX-EXEMPT INTEREST AND DIVIDENDS OF CORPORATIONS

Assuming a married man, living with his wife, and having three children under the age of eighteen years, with an income for the year 1917 of:

Salary		$25,000.00
Interest on tax exempt bonds (U. S. and Municipal)		2,500.00
Dividends of corporations		15,000.00
Interest on mortgages		5,000.00
Total Income		$47,500.00
Excess Profits Tax creditable: [1]		
Salary	$25,000.00	
Exemption	6,000.00	
Tax, 8 per cent. of	$19,000.00	1,520.00
Total Income less credit of Excess Profits Tax		$45,980.00

Computed as follows:

[1] For method of computing excess profits tax, see page 142.

Normal Tax

Total Income less Excess Profits Tax			$45,980.00
Less items not taxable:			
Interest on Government Bonds	$2,500.00		
Dividends of Corporations	15,000.00		17,500.00
Amount taxable, subject to exemptions			$28,480.00
Exemptions:			
Exempt under War Income Tax	$2,000.00		
For 3 children	600.00		2,600.00
Amount subject to Normal Taxes			$25,880.00
As follows:			
2% of amount over $2,600 and not over $4,600	$2,000.00		$40.00
4% of amount over $4,600 and not over $28,480	23,880.00		955.20
Subject to Normal Tax	$25,880.00		
Normal Tax			$995.20
Or, otherwise stated:			
2% of ($28,480 less exemption of $4,600)	$23,880.00		$477.60
2% of ($28,480 less exemption of $2,600)	25,880.00		517.60
Normal Tax			$995.20

Additional Tax (Combined)

Total Income less credit of Excess Profits Tax			$45,980.00
Less Interest on U. S. Gov't and Municipal Bonds (Exempt)[1]			2,500.00
Balance			$43,480.00
Taxable as follows: On amount in excess of:			
$5,000 and not in excess of $7,500	= $2,500	@ 1%,	$25.00
7,500 " " " " 10,000	= 2,500	@ 2%,	50.00
10,000 " " " " 12,500	= 2,500	@ 3%,	75.00
12,500 " " " " 15,000	= 2,500	@ 4%,	100.00
15,000 " " " " 20,000	= 5,000	@ 5%,	250.00
20,000 " " " " 40,000	= 20,000	@ 8%,	1,600.00
40,000 " " " " 43,480	= 3,480	@ 12%,	417.60
Amount subject to surtax	$38,480		
Additional or Surtax			$2,517.60
Total Normal and Additional Taxes			$3,512.80

[1] This item represents income from municipal and U. S. Government bonds. As to deductibility of interest on Liberty Loan bonds, see page 41.

TABLE OF NORMAL AND ADDITIONAL TAXES IMPOSED BY THE INCOME TAX AND WAR INCOME TAX LAWS UPON NET INCOME OF MARRIED PERSONS OR HEADS OF FAMILIES, ON AMOUNTS AS FOLLOWS:

Amount of Income	*Combined Normal Taxes Imposed by Income and War Income Tax Laws less Personal Exemptions*	*Combined Additional Taxes Imposed by Income and War Income Tax Laws*	*Total Combined Normal and Additional Taxes*	
			Amount	*Per cent*
$2,000	None	None	None	.00
3,000	20.00	None	20.00	.67
4,000	40.00	None	40.00	1.00
5,000	80.00	None	80.00	1.60
6,000	120.00	10.00	130.00	2.17
7,000	160.00	20.00	180.00	2.57
8,000	200.00	35.00	235.00	2.94
9,000	240.00	55.00	295.00	3.28
10,000	280.00	75.00	355.00	3.55
15,000	480.00	250.00	730.00	4.87
20,000	680.00	500.00	1,180.00	5.90
25,000	880.00	900.00	1,780.00	7.12
30,000	1,080.00	1,300.00	2,380.00	7.94
35,000	1,280.00	1,700.00	2,980.00	8.51
40,000	1,480.00	2,100.00	3,580.00	8.95
45,000	1,680.00	2,700.00	4,380.00	9.73
50,000	1,880.00	3,300.00	5,180.00	10.36
55,000	2,080.00	3,900.00	5,980.00	10.87
60,000	2,280.00	4,500.00	6,780.00	11.30
65,000	2,480.00	5,350.00	7,830.00	12.05
70,000	2,680.00	6,200.00	8,880.00	12.68
75,000	2,880.00	7,050.00	9,930.00	13.24
80,000	3,080.00	7,900.00	10,980.00	13.72
85,000	3,280.00	9,000.00	12,280.00	14.45
90,000	3,480.00	10,100.00	13,580 00	15.09
95,000	3,680.00	11,200.00	14,880.00	15.66
100,000	3,880.00	12,300.00	16,180.00	16.18
125,000	4,880.00	19,050.00	23,930.00	19.15
150,000	5,880.00	25,800.00	31,680.00	21.12
175,000	6,880.00	33,550.00	40,430.00	23.10

Amount of Income	Combined Normal Taxes Imposed by Income and War Income Tax Laws less Personal Exemptions	Combined Additional Taxes Imposed by Income and War Income Tax Laws	Total Combined Normal and Additional Taxes	
			Amount	Per cent
$ 200,000.....	7,880.00.....	41,300.00.....	49,180.00.....	24.59
250,000.....	9,880.00.....	59,800.00.....	69,680.00.....	27.87
300,000.....	11,880.00.....	80,800.00.....	92,680.00.....	30.89
350,000.....	13,880.00.....	103,800.00.....	117,680.00.....	33.62
400,000.....	15,880.00.....	126,800.00.....	142,680.00.....	35.67
450,000.....	17,880.00.....	149,800.00.....	167,680.00.....	37.26
500,000.....	19,880.00.....	172,800.00.....	192,680.00.....	38.53
600,000.....	23,880.00.....	222,800.00.....	246,680.00.....	41.11
700,000.....	27,880.00.....	272,800.00.....	300,680.00.....	42.95
800,000.....	31,880.00.....	325,300.00.....	357,180.00.....	44.65
900,000.....	35,880.00.....	380,300.00.....	416,180.00.....	46.24
1,000,000.....	39,880.00.....	435,300.00.....	475,180.00.....	47.52
2,000,000.....	79,880.00.....	1,050,300.00.....	1,130,180.00.....	56.51
3,000,000.....	119,880.00.....	1,680,300.00.....	1,800,180.00.....	60.00

NOTE. The amounts of Excess Profits Tax Assessments are deductible from the net income before computing the Income and War Income Taxes shown above. (See page 142.)

V. RETURNS OF INDIVIDUALS

Combined Return.

In the administration of the Income Tax Law, enacted September 8, 1916, as amended, and the War Income Tax Law, enacted October 3, 1917, the requirements of these laws will be combined in one form of return.

Who is Required to Make Return.

Every person, a citizen or resident of the United States, having received from all sources, a net income during the calendar year 1917, and every calendar year thereafter, in the case of: an unmarried person, $1,000 or more; a married person or head of a family, $2,000 or more; will be required to make, execute and file a return of net income.[1]

Return Form.

A "return" is the statement or report of income upon which the Government basis the tax assessment.

[1] Individuals are not permitted to file returns for any period other the calendar year.

No Obligation Upon Government to Send Out Blanks.

There is no obligation upon the part of the Government to seek out those who are taxable or to send the necessary blanks to those of whom returns are required. It is incumbent upon each individual to obtain the blank from the Collector of his district or from the Commissioner of Internal Revenue, Washington, D. C., if he is required, under the law, to file a return.

Income of the husband and wife, if not living apart, may be returned in one report.

Return by Husband and Wife.

If the aggregate income of both husband and wife is $2,000 or more for the calendar year a return of their combined incomes or separate returns of their respective incomes must be made. When separate returns are made the exemption may be prorated by agreement between them but the aggregate exemption deducted shall not exceed $2,000.

Where the income of husband and wife exceeds $5,000 per annum, they should make separate returns because the additional or surtax is computed on the separate income of each individual.

> The regulations of the department requiring the incomes of husband and wife to be combined and authorizing the aggregate exemption of ($4,000) $2,000 from such combined income are applicable for the purpose of the normal tax only. The additional, or surtax, imposed by the act will be computed on the basis of the separate income of each individual; that is, on the amount of each individual's income in excess of the minimum amounts upon which the surtax at the graduated rate is to be calculated. (T. D. 2090.)
>
> The separate incomes of husband and wife should not be combined in a return of income for the purpose of assessing the additional or surtax. (T. D. 2137.)

Returns by Fiduciaries.

All persons and corporations acting in a fiduciary capacity, such as guardians, trustees, executors, administrators, receivers, conservators, must make and render a return of net income of the person, trust or estate for whom or which they act (Form 1041, Revised) and are subject to all the provisions in regard thereto that apply to in-

dividuals. Where there is more than one person or corporation acting in a fiduciary capacity, the return of one is sufficient, provided that such return is a complete report upon all income received.

The fiduciary should only account for income received through him except where he acts as agent or attorney in fact for the beneficiary.

> As each such fiduciary acts solely in behalf of the beneficiaries of the trust, the annual return required in such cases has reference only to the income accruing and payable through said fiduciary, and not to the income of the beneficiary derived from other sources. If, however, such fiduciary is legally authorized to act for such beneficiary as agent or attorney in fact, he may in such case also make for the beneficiary the personal annual return (Form 1040) required by law. (Art. 72, Reg. 33.)
>
> Unless the beneficiary is under some disability which requires the fiduciary to act, the beneficiary will make his own return and account for the tax upon his entire net income. (T. D. 2090.)

An executor or administrator is required to make a return of the income received by the decedent for the period from the first day of January to the date of the decedent's death. (Form 1040 Revised.)

A person acting under a power of attorney is not construed to be a fiduciary and is not required to render return of receipts and disbursements in his representative capacity. Should he, however, have title to property, from which there is income, irrespective of actual ownership, he must make return of such income. A property owner cannot conceal his income by assigning it to a representative for the purpose of escaping the tax. Where there is a transfer of vested interest in property the transferee must include in his return not only such part of income as has been paid to the principal but the undistributed portion as well.

Agent Acting Under Power of Attorney.

If, by reason of illness, absence or nonresidence, a person is unable to render a return in due time, then the return may be made by an agent having knowledge of the affairs of such person whose return he makes. Such agent

Return by Agent.

is subject to all penalties provided for erroneous, false or fraudulent returns.

> When by reason of minority, absence, sickness, or other disability the individual is unable to make his own return, the same shall be made by his guardian or duly authorized agent. (Art. 17, Reg. 33.)

Returns of Private Banks.

Private banks, distributing their income according to investment of members and exercising corporate form of organization, should make returns in the same form as corporations. The income received by the members of such private bank, is not subject to the normal tax in the returns of net income of the member.

> Private banks which have the form of corporate organizations, elect officers and a board of managers, have a distinctive name, a fixed situs, and distribute their net earnings upon the basis of the amount of capital invested by the members or owners, are held to be associations within the meaning of the Federal income tax law, and in their organized capacity should make returns of annual net income and pay any income tax thereby shown to be due.
>
> The holders of the stock or the owners of the bank will be exempt from the normal tax to the extent of the dividends or earnings which they receive from such private banks as make returns in their organized capacity and pay income tax in accordance therewith. . . . (T. D. 2137.)

The foregoing is true, also, in the case of income from private banks which are recognized as associations for income tax purposes.

> In the case of private banks which have the form of corporations and which are held to be associations within the meaning of the Federal income tax law, it is not the purpose of this office to assess the income tax against such banking associations and then also against the individual members of the association.
>
> Income which the members of the association receive from the bank because of their investments therein will be considered dividends. . . . (T. D. 2152.)

A banking firm doing business as a partnership (not limited) and which has not a formal corporate organization or that of

an association is not required to make returns of net income except under the War Excess Profits Tax. The members of the partnership will include in their respective individual returns the income received from the partnership.

A bank owned by one person is not construed to be an association under the income tax law and is not required to make returns of net income such as are required of corporations and associations. The income of such bank would be included in the return of the individual owner together with income from all other sources of such person.

Citizens Residing Abroad Must Make Return.

The fact that an American citizen resides abroad and pays an income tax to the country wherein he resides, does not excuse him from paying an income tax in the United States. He is required to make a return of all his income to the Collector in the district of his legal residence or principal place of business in the United States. If a citizen, residing abroad, has no residence or place of business in the United States, his return should be made to the Collector of Internal Revenue, Baltimore, Maryland, which is the collection district of Washington, D. C.

To Whom Return is Made.

A true and accurate return of net income must be filed with the Collector of Internal Revenue for the district in which the person has his legal residence or principal place of business, or if there be no legal residence or place of business in the United States, then with the Collector of Internal Revenue, Baltimore, Maryland.

Verification.

Every return is required to be verified by the oath of the party rendering it.

Verification of Returns by Persons in Naval or Military Service.

For the purpose of verification of returns of income by persons in the Naval and Military service of the United States, any officer in the Naval or Military Service of the United States, within or without the United States, who is authorized to administer oaths under the provisions of Section 4, Act of July 27, 1892, 27 Stat. 278, providing for the administration of oaths, for the purpose of Military justice and administration or under the provisions of Act of March 4, 1917, Public 391, page 4, providing for administration of oaths for the purpose of Naval justice and

administration, is hereby empowered and authorized to take the acknowledgment of such persons making returns of income.

In all such cases the certifying officer shall place under his name the official designation under which he acts. (T. D. 2534.)

Due Date of Filing.

The return for the year ending December 31, 1917, must be filed on or before March 1, 1918, and the return for each calendar year thereafter must be filed on or before March 1st, next succeeding such calendar year.

Extension of Time to File Return.

In case of inability, occasioned by sickness or business, to file a return in due time (March 1) application for extension of time should be made in writing to the Collector, on or before the day on which the return becomes due, for an extension of time; such extended time cannot exceed thirty days from March 1st, except that the Commissioner of Internal Revenue (Washington) has authority to grant a further reasonable extension of time, in meritorious cases, to persons traveling or residing abroad.

Penalty for Failure to File Return.

Failure to file returns may be due to one of two reasons, or both: delinquency or refusal. In case of mere delinquency, where there is no wilful intent to violate the law, it seems that the Collector may accept offers in compromise in lieu of specific penalties imposed by the law. Where, however, there is a refusal or wilful intent to violate the law, an offer of compromise will not be accepted in lieu of the specific penalty.

Any person that refuses or neglects to make a return of annual net income, who is subject to a tax by provision of law, is liable, under the law, to a penalty of not less than $20 nor more than $1,000.

In case of failure to make and file a return within the time prescribed by law or by the Collector, the Commissioner of Internal Revenue will add to the tax a penalty of 50 per cent. of its amount except that, when a return is made voluntarily and without notice from the Collector after the due time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition will be made to the tax.

In case a false or fraudulent return is made wilfully, the Commissioner of Internal Revenue will add to the tax a penalty of 100 per cent. of the amount thereof. **False Return Penalty.**

The law further declares that any individual required thereunder to make, render, sign or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade an assessment will be guilty of a misdemeanor and subject to a fine not exceeding $2,000 or imprisonment for a period not exceeding one year, or both, in the discretion of the court, together with costs of the prosecution.

In cases of refusal or neglect to make a return, or in case of an erroneous, false, or fraudulent return having been made, the Commissioner of Internal Revenue has the right to make a return in behalf of the party taxable at any time within three years after said return is due or has been made, and the assessment made by the Commissioner in such case shall be payable by such person, or persons, immediately upon notification of the amount of such assessment. **When Internal Revenue Officers May Prepare Return.**

The Commissioner of Internal Revenue is required, on or before the first day of June of each year, to notify all taxable persons of the amount that they have been assessed. The tax becomes payable on the 15th day of June. After ten days' notice by the Collector, there will be added to the unpaid taxes interest at the rate of 1 per cent. per month from the time that the tax becomes due and an additional penalty of 5 per cent. of the amount of the tax. **Due Date of Payment Penalty for Delayed Payment of Tax.**

Claims for refund of taxes after assessment has been fixed, should be made on Form 46, to which should be attached the receipt for taxes paid sought to be recovered. **Claims for Refund of Taxes.**

Claims for abatement of taxes or penalties must be made on Form 47. Each of these claims must be supported by the affidavit of party aggrieved, and by affidavit of the Collector or Deputy Collector of the district in which the claim is made.

The present income tax law provides that claims for the re-

fund of taxes paid under the Excise Act of August 5, 1909, and the Income Tax Act of October 3, 1913, which have been rejected by reason of the statute of limitation in existence prior to September 8, 1916, may be reopened, provided that such claims for refund involve a review of the return on which the claim is made. This question was ruled upon in T. D. 2396, dated November 1, 1916, containing a letter written to the Collector of Internal Revenue, Los Angeles, California, as follows:

Claims for Refund.

> "This office is in receipt of your letter of the 26th ultimo, asking for a ruling as to whether, under section 14, paragraph A, of the act of September 8, 1916, claims for refund which have once been rejected by the commissioner because of the statute of limitation in existence at that time may be reopened. The portion of section 14 referred to is in the following words:
>
> "'Provided, That upon the examination of any return of income made pursuant to this title, the act of August 5, 1909, . . . and the act of October 3, 1913 . . . if it shall appear that amounts of tax have been paid in excess of those properly due, the taxpayer shall be permitted to present a claim for refund thereof notwithstanding the provisions of section 3228.'
>
> "This office is of the opinion that claims can now be made for refund under that provision. Claims rejected can also be reopened if the question involves an examination of the return. The power does not extend to other claims whose adjustment does not necessitate an examination of the return."

By amendment of the Act of September 8, 1916, it is provided that advance payments of income and war income taxes will be accepted either in whole of an estimated amount of assessment or in instalments, in consideration of which, an allowance not in excess of 3 per cent. will be credited on account of taxes so paid.

Advance Instalment Payments of Taxes.

On the instalment basis of payments not more than four payments will be accepted, each of them at least one-fourth of the estimated total tax and the payments must be made of such amounts, respectively, within thirty days, two months, and four months after the close of the taxable year and the

fourth payment on or before the due date of the full payment, June 15th. Where the return is made for the calendar year the respective payments would become due as follows:

At least ¼ before January 31,
" " ¼ " February 28,
" " ¼ " April 30,
Balance on or " June 15.

Any amount overpaid will be refunded as a tax erroneously collected.

Failure to pay the instalments in due time will work a forfeiture of any benefit for advances made. All penalties under existing law for failure to make payments when due are made applicable to any failure to pay the tax at the time or times required under the instalment plan of payment.

Uncertified cheques will be accepted in payment of income and excess profits taxes under regulations to be made by the Commissioner of Internal Revenue. If a cheque should not be paid by the bank on which it is drawn the person by whom the cheque was tendered will be liable for the payment, penalties and additions as if the cheque had not been tendered. **Forms of Payment.**

Certificates of indebtedness of the United States issued under the Act of April 24, 1917, or of any subsequent Act will be accepted at par plus accrued interest in payment of income and excess profits taxes.

By provision of Section 5 of the War Revenue Bill of October 3, 1917, the War Income Tax is not applicable to Porto Rico and the Philippines. The Legislatures of both of these possessions are given the power to amend, alter, modify or repeal the income tax laws in force at these places respectively. **Porto Rico Philippines.**

VI. Income of Individuals

Income, for the purpose of the tax, comprehends revenue and income from all sources, as follows: gains, profits, salaries and wages received, including income from professions, vocations, business, trade, commerce, sales, dealings in or use of real and personal property, rents, interest, dividends, securities, transactions of any business for **Income Defined.**

gain or profit and income derived from any other source whatsoever, in whatever form paid.

Undivided Surplus of Corporation.

Although the law provides that the taxable income of an individual shall include the share to which he would be entitled as stockholder or otherwise of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies or associations, or insurance companies, yet it does not impose upon the stockholder the duty of ascertaining his share of an undistributed surplus.

Where a surplus is accumulated beyond the reasonable needs of the business, such unreasonable accumulation shall be *prima facie* evidence of a fraudulent purpose to escape the tax.

> But the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company or association, or insurance company shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed. (Section 3, Act of September 8, 1916.)

Dividends. Life Insurance Policies.

Dividends received from a life insurance company on a policy that has not matured are not taxable as income, whether paid by cash or deducted from current premiums.

Dividends received on a paid-up policy, however, should be treated the same as stock dividends, free from the normal tax and only taxable when the person receiving the same has an annual income in excess of $5,000, whereupon it is subject to additional or surtaxes under the War Income Tax Law (Act of October 3, 1917) and in excess of $20,000, when it is subject to surtaxes under the Income Tax Law (Act of September 8, 1916).

> The amount paid under a life insurance, endowment, or annuity contract is not income when returned to the person making the contract, either upon the maturity or sur-

render of the contract; but the amount by which the sum received exceeds the sum paid and coming into the hands of the person making the contract and payment is income. (T. D. 2090 as amended by T. D. 2152.) **Annuities.**

Proceeds of life insurance policies paid upon the death of the insured are not taxable to the beneficiary. **Principal Life Insurance Policies.**

Money received by an injured person under an accident policy of insurance is, for income tax purposes, deemed to be income.[1] Payment to a beneficiary, however, of the proceeds of an accident insurance policy, upon death of the insured, is not taxable as income. (T. D. 2135.) **Accident Insurance.**

Amounts received from a railroad company as reimbursement for expenses occasioned by an accident, are not considered income subject to tax. (T. D. 2135.) **Damages. Injuries.**

Amounts received, however, in compromise or settlement of an action for "pain and suffering" is held to be such income as is taxable, as, "gains or profits and income derived from any source whatever." Amounts so received are considered in their nature similar to those received by the insured under a policy of accident insurance by reason of an accident sustained. (T. D. 2135.)

Dividends are defined in the Act of October 3, 1917, as any distribution made or ordered to be made by a corporation out of its earnings accrued since March 1, 1913, whether payable in cash or stocks. Under this definition the declaration of a dividend alone is sufficient to create an obligation on the part of the stockholder to include his share thereof in his return, but the Department has consistently held that dividends should be entered in the annual return of the recipient for the year in which such payments were received. **Dividends.**

In so-called "close corporations" it is not unusual to credit to the account of the respective stockholders the share of profits to which each is entitled without formal declaration. Such credit is equivalent to a declaration and makes the stockholder accountable for the full amount of such credit whether withdrawn or not.

Corporations are required to pay the tax of 2 per cent. under

[1] An amount received by an employee in settlement of a claim for injuries sustained, pursuant to accident compensation laws of a state, has been held to be taxable income.

the Act of Sept. 8, 1916, and 4 per cent. by Act of Oct. 3, 1917, on their entire net income except as to deduction of the War Excess Profits Tax. Hence, a dividend received by a stockholder has already been subjected to the normal tax rates and the shareholder receives the same free of such taxes. Dividends are, however, subject to the additional or surtaxes of both Acts (Sept. 8, 1916, and Oct. 3, 1917). It follows, therefore, that where the net income of a stockholder exceeds $20,000, dividends are taxable under the Act of 1916 and net income in efcess of $5,000 subjects dividends to surtaxes under the Act of 1917. An income of $5,000 or less, consisting wholly of dividends, is not taxable; but the recipient must make a return if such income exceeds the amount of exemption to which he is entitled.

Dividends Earned Prior to March 1, 1913.

Under the Act of September 8, 1916, dividends paid out of surplus accumulated prior to March 1, 1913 (incidence of the individual income tax) were not taxable to the individual. In connection therewith the Internal Revenue Department ruled that a corporation, to make such dividends free of tax to the stockholder should specifically inform the stockholder that the dividends were declared and paid out of such surplus and profits and required that entry be made upon the books of the corporation showing from what surplus the dividends were paid; without such segregation and notice the dividends were construed to have been paid out of current earnings. The stockholder was not justified in omitting the dividends from his return unless he had received from the paying corporation a statement specifically declaring that the dividend, or part thereof, had been paid out of undivided profits accumulated prior to March 1, 1913.

By Act of October 3, 1917 [Section 31 (b)] dividends distributed during the year 1917 and thereafter will be deemed to have been paid from the most recently earned profits or surplus and will be taxed to the recipient at the rates existing by law for the years in which the profits or surplus were accumulated. But this limitation will not apply to any distribution made prior to August 6, 1917, out of undivided earnings accrued prior to March 1, 1913. For example: A dividend declared at any time prior to August 6, 1917, payable out of surplus profits accumulated prior to March 1, 1913, is free of the surtax to the

stockholder. A dividend declared at any time during the year 1917 or thereafter (except that declared prior to August 6, 1917, specifically out of profits earned prior to March 1, 1913, ante) is deemed to have been declared out of the earnings of the current year. If the earnings of the current year were less than the amount of the dividend, then the remainder out of the earnings of the previous year, and so on. Assuming an extreme case: A corporation on September 30, 1917, had a surplus of $150,000 accumulated during periods, as follows:

Prior to March 1, 1913	$50,000.00
March 1, 1913, to December 31, 1915	20,000.00
January 1, 1916, to December 31, 1916	30,000.00
January 1, 1917, to September 30, 1917	50,000.00

On September 30, 1917, the corporation declared a dividend aggregating $120,000; then 50,000/120,000ths or 5/12ths of such dividend is subject to rates of taxes imposed by the Act of October 3, 1917[1]; 3/12ths or 1/4th at the rates prescribed by Act of September 8, 1916;[2] 2/12ths or 1/6th at the rates exacted under the Act of March 1, 1913[3]; and the remainder of 2/12ths or 1/6th, deemed to have been declared from the surplus accumulated prior to March 1, 1913, bears no tax.

Stock Dividends.

Dividends declared payable in stock of the declarant corporation are subject to the same rates of taxes as are imposed in the case of cash dividends, and will be considered income to the amount of earnings so distributed [Section 31 (a)], and not, as heretofore, to the amount of "cash value" thereof.

Dividends Declared Payable in Securities.

Dividends declared payable in securities should be stated in the return of the stockholder at the amount of earnings or profits distributed. The amount of earnings distributed is determined by the amount charged to surplus account on the books of the declarant corporation. For example, dividends declared payable in Anglo-French bonds at 95, will be returnable by the recipient, for

[1] Income and War Income Surtaxes, page 5.

[2] For rates see page 2.

[3] For rates see Appendix, page 320.

[4] A dividend declared out of capitalized good will is not a distribution of profits of the corporation and the recipient need not report same as income until the stock is sold by him; then, however, the proceeds of sale are subject to both normal and additional taxes.

income tax purposes, at the aggregate amount of such bonds received, computed at $95 on each $100 of the par value thereof.

Dividends Issued out of Reserves for Depreciation Depletion.

Under date of April 10, 1917, the Department issued a letter to collectors and Internal Revenue agents from which the following are extracts:

"The 'second' paragraph under Sec. 12 of Title 1 of the Act of September 8, 1916, authorizes corporations, joint-stock companies, etc., in making their returns of annual net income, to deduct from gross income—

"'all losses actually sustained and charged off within the year . . . including a reasonable allowance for the exhaustion, wear and tear of property, arising out of its use or employment in the business or trade'

"and in the case of oil and gas wells and mines, a reasonable allowance for depletion of natural deposits.

"The essential requirements of this provision are that the amount deductible on account of depreciation and depletion shall be charged off and shall be reasonable allowances—that is, an amount sufficient to make good the loss due to these causes. The phrase 'charged off' contemplates that the 'reasonable allowance' deducted from gross income on account of depreciation or depletion, shall be credited to appropriate reserve accounts and carried as a liability against the assets, to the end that when the total of these credits equals the capital investment account, no further deductions on these accounts will be allowed.

"While the presumption is that amounts credited to these accounts will be used to make good the loss sustained, either through a renewal or replacement of the property or a return of capital, there is no requirement of law that the funds represented by these reserve liabilities shall be held intact or remain idle against the day when they may be used in making good the depreciation of the property with respect to which the deduction is claimed, or in restoring the capital invested in the depleted assets.

"The conversion of the depreciation reserve into tangible assets will not constitute such a diversion as would deny the corporation the right of deduction, provided in all cases, that the deduction claimed in the return is a reasonable allowance, that is, a fair measure of the loss due to 'exhaustion, wear and tear of property, growing out of its use' and is charged off or so entered upon the books as to

constitute a liability against the assets with respect to which the depreciation deduction is claimed."

The only principle upon which depreciation may be deducted from income is by reason of deterioration or wear and tear having occurred in the property depreciated. Such having taken place the property must be assumed to have decreased in value, and to record that reduction in value an offset to the property account is shown by a reserve for such reduction, namely, a reserve account. Hence, the reserve, appearing upon the credit side of a double entry ledger, is not offset by any property among the assets except the particular property which it qualifies, and, as to that, it is a modification of the book value.

The concession that "The conversion of the depreciation reserve into tangible assets will not constitute such a diversion as would deny the corporation the right of deduction, provided . . . " the deduction is fair, must be predicated upon an understanding that the reserve exists apart from the account that it qualifies. Such so-called reserve merely "negatives" the property account to which it relates and any different acceptance of it will lead to a misapplication of the reserve. A reserve which exists merely as a modification of a property account, and, in effect, is a reduction of the book value thereof, is not such an entity as is convertible "into tangible assets" but merely indicates a reduced value of property already a part of the corporation's assets. If it were otherwise, the corporation could purchase stocks, bonds or anything else, charge the cost thereof to the reserve for depreciation and thereby reduce the reserve, and, at the same time, create a fund that would not appear upon the books of account. Without question such use of a so-called reserve for depreciation would be an evasion of law and a distortion of facts.

On October 10, 1917, the Department issued T. D. 2540, in the form of a letter to collectors of Internal Revenue to the effect that dividends paid out of reserves for depreciation are taxable as income to the stockholder and are not a return of principal, as follows:

"To Collectors of Internal Revenue:

"Referring to the practice of certain corporations of declaring dividends out of reserves set aside to meet de-

preciation and depletion of property, and of advising stockholders that such dividends represent a distribution of capital assets, your attention is directed to the ruling made herein as follows:

"All such dividends received by stockholders declared out of such reserves accumulated subsequent to March 1, 1913, constitute income to the stockholder under the Act of September 8, 1916, and most be accounted for in returns of net income.

"A stockholder's investment is in the stock of a corporation. If he disposes of his stock for more than its fair market value on March 1, 1913, or its cost if acquired since that date, the profit realized must be returned as income; if he disposes of it at a loss, the loss sustained is deductible from gross income within the limits of the taxing act. In computing the profit or loss sustained there must be taken into account dividends paid from reserves accumulated prior to March 1, 1913, which were not returned as income for the year in which received, under the provisions of the Act of September 8, 1916.

"All rulings in conflict herewith are hereby revoked.

"DANIEL C. ROPER,
"Commissioner of Internal Revenue."

A reserve for depreciation should not be used for any purpose except as an offset to the property account that it qualifies or for charges of renewals and replacements. If an investment fund is created for purposes of renewals the amount set aside or reinvested is merely a conversion of one form of asset into another and bears no relation to the reserve account except to furnish available means with which to make replacements. There can be no objection to paying a dividend with the invested fund, but a dividend cannot be declared out of a reserve for depreciation because the so-called reserve is not surplus of the corporation.

Purchases and Sales of Stock of Same Issue.

Where stock of the same company is frequently bought and sold and the cost of the particular stock sold is not ascertainable, the cost should be determined by the cost of that first purchased remaining unsold.

"This office acknowledges the receipt of a copy of a letter

received by you under date of February 8, 1916, wherein your correspondent requests to be advised how the amount of profit to be returned for Federal Income Tax purposes should be computed in cases where various parcels of stock of the same issue are bought and sold at different dates. In reply you are advised that the office holds that whenever possible, the shares sold shall be identified by the number of the certificates covering them. When stock is sold, and its identity cannot be determined, it should be charged against the stock first purchased and remaining unsold. If the purchase occurred on or after March 1, 1913, the entire amount of difference should be returned." (Letter to the Corporation Trust Company, signed by Commissioner W. H. Osborn, and dated February 26, 1916.)

Where a corporation is formed for the purpose of taking over the assets of an existing corporation which issues to the stockholders of the old company capital stock (of the new company) in exchange for the old at the same par value, no income accrues to the old corporation notwithstanding that the actual value of the stock of the old company is admittedly worth at least double the par value; no taxable income accrues to the stockholders until they sell their holdings in the new company.

Exchange of Stock.

"This office is in receipt of your letter of the 7th instant, in which you submit certain inquiries with respect to the following proposition:

"A domestic corporation having an authorized capital stock of $750,000, in 1910, acquired certain properties representing an investment of its entire issued capital stock of $525,000. This is the present total issue of the Company.

"It is now proposed, for certain internal and other reasons, to incorporate a new company with an authorized capital stock of $750,000, being the same capital stock as the first company. The new company to take over the real property of the first company and issue in exchange for such real properties $525,000 of the capital stock of the second company.

"The capital stock of the second company thus issued would be distributed among the stockholders of the first company, through the medium of Trustees or otherwise, share for share, in exchange for their holdings in the first

company, which would then be surrendered. This would leave the stockholders of the first company with a share of stock in the second company for every share they held in the first company.

"The first company, after this transfer had been completed, would be dissolved.

"Since the incorporation of the first company, in 1910, however, the real property owned by it, has shown considerable increase in value and the shares of the first company are now worth at least double par.

I

"In reply to your several inquiries, you are informed that the shares of stock authorized and issued, being the same as to both corporations, and there appearing to be no consideration to the first company for its assets, other than the $525,000 par value of the second company's stock, an amount exactly equal to the par value of the first company's stock out-standing, no profit taxable under the income tax law would accrue to the first company as the result of this transaction, it being understood that the stock of the second company would be distributed upon even terms to the stockholders of the first company in exchange for the stock of such first company held by them, which stock so taken up would be cancelled. The exchange of stock, that is the issuance of stock by the second corporation for the stock of the first corporation, share for share, of like par value, would not constitute a stock dividend, and an exchange on the basis indicated would not result in any taxable income to the stockholder of the first company receiving in exchange for their former holdings the stock of the second company. The stock, both authorized and issued, being in both cases of like par value and being predicated upon exactly the same assets, the transaction constitutes a deal by which the second company takes over the assets of the first company, giving therefor its stock of a par value exactly equal to the par value of the stock of the first company outstanding, thus placing in the hands of the stockholders the same number of shares of the second company and same par value as that which they theretofore held in the first company, the stock in both cases being supported by the same assets. Hence the transaction resulted in no gains, profits

or income to either the first corporation or its stockholders. If, as you say, the stock of the first company at the time of this transaction, was worth 'double par,' the stock of the second company being supported by identically the same assets, is presumably of the same value and the exchange of the new stock for the old, results in no income subject to tax. It is simply an exchange of assets of like character and like value.

II

"It may be stated, however, that if the stockholders in the new company shall hereafter sell their stock, they will be required to account for as taxable income, any amount which they may receive for the same in excess of the cost to them of the stock of the first company, if such stock was acquired subsequent to March 1, 1913, or any amount which they may receive in excess of the fair market value or price of the stock of the first company if same was acquired prior to March 1, 1913. In other words, the cost to the stockholders of the old company's stock or its fair market price or value as of March 1, 1913, as the case may be, will be the basis for computing any gains or losses to the stockholders that may result from the sale of their present holdings of the new company's stock." (Letter to the Corporation Trust Company, signed by Acting Commissioner David A. Gates, and dated March 8, 1917.)

Additional Stock Received in Reorganization Deemed Income.

The exchange of capital stock of a corporation for the capital stock of another corporation, where one is formed for the purpose of taking over the other, resulting in an increased capitalization and yielding to the stockholders of the reorganized company a larger amount of stock at the par value, renders such increase taxable as income, both to the selling corporation and the recipient shareholders.

"The present holding of this office is that in all cases wherein a corporation sells and transfers its assets to another corporation, the amount received by the selling corporation in excess of the cost of the property sold will be considered income to such selling corporation, and, for the purpose of the tax, may be prorated over the number of

years the property was held prior to the date of its sale, and the amount to be returned for the year in which the sale was made for the purpose of the tax is the amount apportioned to the years subsequent to January 1, 1909.

"If the shares of stock received by the selling corporation are distributed by it to its stockholders, the amount so distributed in excess of the stock held by them in the original corporation will be considered income to such stockholders and, for the purpose of the supertax, should be returned by them when the net income (inclusive of such dividends) of such individuals, for any one year, is in excess of $20,000. (After January 1, 1917, also subject to the War Income Tax—in excess of $5,000.)

"The selling corporation being taxable on the excess of the stock received over the cost of the assets sold, the individuals receiving the excess in the form of stock of the purchasing company will not be required to return their respective shares of such excess for the purpose of the normal tax." (Extract from letter to A. C. Kahn, New York, N. Y., signed by Commissioner W. H. Osborn, and dated September 9, 1916.)

Sale of Stock Rights.

Sales of "rights" to subscribe to capital stock, accruing to stockholders in the case of new issues, are deemed to be income.

"The income tax law levies the tax upon income accruing from all sources and under these circumstances, it is held by this office that income accruing to an individual who holds stock in a corporation by reason of the sale of his rights to subscribe to new stock in the corporation is such an item of income as should be included in his return of annual net income for the assessment of the tax." (Extract from a letter signed by Deputy Commissioner L. F. Speer and dated February 27, 1915.)

Scrip Dividends.

Dividends received in the form of scrip should be reported as income at the face value thereof. In the event that the same is not paid upon maturity, or should in the meantime become worthless, it may be deducted from the return of the year in which it turns out to be uncollectible.

Dividends received from foreign corporations, not subject

to the income tax in the United States, are not free from normal taxes and may not be deducted as such in the return of the recipient. If, however, the business of such foreign corporation is confined to the United States and it pays income taxes on its net income the dividends paid by it should be treated the same as dividends paid by a domestic corporation.

Dividends Received From Foreign Corporation.

> Dividends declared and paid by a foreign corporation which derives its entire income from business done wholly within the United States and pays, under the provisions of the Federal Income Tax Law, a tax upon its net income, should be treated in the same manner as dividends from domestic corporations. (T. D. 2090.)

Dividends may only be declared out of profits and surplus earnings except where the corporation is being dissolved or liquidated, in which case the dividend is a return of capital to the stockholder. Dividends issued by a liquidated corporation up to the amount of cost of the stock to the shareholder is not taxable under the income tax; any amount in excess of the cost thereof, however, is income and, hence, is taxable.

Return of Capital not Income.

Limited partnerships, for the purpose of income taxation, are treated as corporations. Hence, income distributed by such partnerships to their members, of which the partnership has made return on the same form (blank) as required of corporations, is free of normal taxes to the recipient.

Profits of Limited Partnerships.

> The profits of limited partnerships making returns in the same manner as corporations make returns will be treated the same as dividends of corporations and will be returned in the returns of individuals in the same manner as are dividends upon the stock of corporations; that is to say, the dividends received from such limited partnerships will not be subject to the normal tax in the hands of the members of the partnership receiving the same. (T. D. 2137.)

Salaries When Returnable.

Salaries are not required to be reported as income until actually received.

"An amount of salary which was earned during the year

1914 (1915) and was not received until some date subsequent to December 31st of that year, need not be returned as income for the year in which earned, but should be returned for the year in which received if the person receiving the same is a taxable person required to render a return." (Extract from letter to Cary, Piper and Hall, signed by L. F. Speer and dated March 1, 1915.)

Salary Paid by Stock.

In the absence of a ruling under the amended law, it seems plausible that a salary paid in the capital stock of a corporation is taxable to the recipient at the amount of salary received and not at the "cash value" of the stock, as heretofore. If the stock so issued, is of the original issue of the corporation, it must be paid for at par and so reported by the recipient. Should the stock be issued from so-called "treasury stock" (fully paid on the records of the corporation) at a price less than the par value, it would seem reasonable that the recipient should report as income the amount of salary of which the stock was payment. When he disposes of the stock the amount realized in excess of the amount of salary reported will be income for the year in which the stock was sold.

Salaries Received from Exempt Corporations.

Salaries received by employees of organizations exempt under the income tax law are subject to the tax and should be reported in the return of the employee. (T. D. 2090.)

Living Quarters Part of Compensation.

When an individual is furnished living quarters in addition to salary, the rental value of such living quarters is regarded as compensation subject to the income tax. (T. D. 2090.)

Board, Lodging, etc., in Lieu of Cash.

Board, lodging or other consideration received in lieu of rental is considered income equal in amount to the indebtedness in payment of which it is received, and should be included in any return of annual net income its recipient is required to render under the provisions of the income tax law. (T. D. 2135.)

Bonuses.

Bonuses received from employers in the nature of additional compensation, and not as gratuities, are taxable as income of the recipient. (See page 108.)

Commissions paid to salesmen are deductible expenses of the payer and should be reported as income in the return of the recipient. (T. D. 2090.) **Salesmen's Commissions.**

Fees for professional services need not be returned as income until received. Promissory notes, however, received in payment of such fees shall be deemed to be income received. **When Professional Fees are Returnable.**

> "This office holds that money due for professional services of lawyers, physicians and the like should be entered on the annual return for the year in which such payments were received." (Extract from letter to Beekman, Menken and Griscom, signed by Commissioner W. H. Osborn and Dated February 18, 1915.)

Fees received by clergymen, in addition to salary compensation, for any form of service, are construed to be taxable income. **Clergymen.**

> Easter offerings, and fees received by clergymen for funerals, masses, marriages, baptisms, etc., are considered income subject to tax under the provisions of the income tax law of October 3, 1913. Christmas gifts, however, are not considered income within the meaning of the law and should not be included in a return. (T. D. 2090.)

Compensation received by a trustee covering a period of years and not paid or reported as income until maturity of trust, has been held to be returnable in the year received and deductions therefrom may not be prorated over the years of the trusteeship. Only deductions applicable to the year income is returned are allowable. (T. D. 2135.) **Compensation of Trustee.**

Profit on the sale of capital assets is returnable as income. The profit on sales of capital assets acquired prior to March 1, 1913, is the excess of the selling price over the fair market price or value of such property as of March 1, 1913. In the case of property acquired since that date the profit is the selling price in excess of the cost. If the capital asset is one on which depreciation has been charged off, such depreciation should be taken into consideration in determining the profit or loss. For example, a machine purchased on January 1, 1914, for $1,000 on which depreciation had been **Profit on Sales of Capital Assets.**

charged off at the rate of 10 per cent. per annum for years 1914 and 1915, and which was sold on January 1, 1916, for $850, would show a profit of $50, derived as follows:

Selling price		$850.00
Cost	$1,000.00	
Less depreciation charged off, 20% (2 years @ 10%)	200.00	
Cost, less depreciation		800.00
Profit		$ 50.00

The law makes no mention of depreciation charged off prior to the time of sale, nor has there been any ruling on the question. From an accounting point of view, however, there is only one logical conclusion in the matter of ascertaining the profit or loss and that is to deduct whatever depreciation had previously been charged off. If repairs had been charged against the reserve for depreciation then the cost of such repairs would be a reduction of the depreciation deducted from the cost of the machine in determining amount of profit on the sale. Assuming in the above example that repairs and renewals costing $25 had been charged to the reserve for depreciation, the result would be as follows:

Selling price			$850.00
Cost		$1,000.00	
Deduct:			
Depreciation charged off, (20%)	$200.00		
Less, repairs charged to depreciation	25.00		
		175.00	
Cost, less unused depreciation			825.00
Profit			$ 25.00

Computing Profit or Loss on Property Acquired Prior to March 1, 1913.

The date of the adoption of the income tax amendment to the Constitution was March 1, 1913. In order that taxpayers should not pay a tax upon accrued profits on, or enhanced values of property, which had theretofore been acquired, and, also, for the purpose of preventing the deduction of losses that had been sustained on property then held, the law provides that for the purpose of ascertaining the profit or loss on property acquired prior to March 1, 1913, such property

shall be valued at the market price or value on March 1, 1913.

In determining the fair market price or value for the purpose of ascertaining the profit or loss on the sale of stock or bonds acquired prior to March 1, 1913, where such stocks or bonds are dealt in on the exchange, it has been stated by the Commissioner of Internal Revenue in a letter to the Corporation Trust Co., dated November 21, 1916, that such fair market price would be the average price at which such securities sold on March 1, 1913, and not the price at which they sold at any particular time of the day. The acceptability of market quotations is, nevertheless, conditioned upon the same being the "fair market price or value." The price or value of property should be determined upon all the relevant facts governing the particular case.

Fair Market Price or Value of Securities.

Application of the prescribed method of computing the profit or loss on property acquired prior to March 1, 1913, sometimes produces a most unreasonable and unsound result. For example, stock was purchased in 1912, at par value, $100 per share; on March 1, 1913, the market value thereof was $60 per share; and in 1916 the stock was sold at $95 per share. An income tax return for the year 1916, reflecting these facts, would show a profit of the difference between the market price on March 1, 1913, $60, and the selling price, $95, namely, $35 per share. This phantom profit never existed except for income tax purposes. There was actually a sustained loss of $5 per share. Applying the same state of facts to a fiduciary or trustee, who, in 1916 was accounting in Court to the beneficiaries, such trustee, would, in his accounts submitted to Court, show a loss of $5 per share, and at the same time would show by such account an expenditure for income taxes on a profit of $35 per share of stock that was actually sold at a loss. The fallacy of the method in the circumstances described, is so apparent that no Court could reasonably enforce it. It is suggested, when a situation arises, such as the one pointed out, that all the facts of the particular case be placed before the Commissioner of Internal Revenue with a request for a special ruling thereon.

Profit or Loss Securities Acquired Prior to March 1, 1913.

Profit Defined.

Profit, for income tax purposes, has been defined as the difference between the selling price and the cost, where the selling price is more than the cost. (T. D. 2090.)

Sales of Real Estate.

The rulings as to what constitutes returnable profit on sales of real estate by corporations are also applicable to individuals. (See page 94.)

Cost of Property.

The cost of property acquired subsequent to the incidence of the tax (March 1, 1913), will be the actual price paid for it, together with the expense incident to the procurement of the property in the first instance and its sale thereafter, and the cost of improvement or development if any. (T. D. 2005.)

Appreciation not Income.

An increase in the book value of assets to conform with appraisal values, or for other purposes, does not render such increase taxable as income. (See also "Investments, stock and bonds," page 187.)

The following is an extract from a letter to Collectors of Internal Revenue, dated August 14, 1914.

> Returnable and taxable income is that actually realized during the year, that is, that which is evidenced by the receipt of cash or its equivalent. Until any appreciation taken up on the books has been so realized, it will not be required to be returned as income. Hence, in the preparation of returns and in the examination of books for the purpose of verifying the same, mere book entries of appreciation in the value of capital assets will be disregarded.
>
> It should be understood, however, that in the event of the sale of the assets, the increase in whose value has been taken up on the books, the profit or income to be returned as a result of the sale will be determined upon the basis of the difference between the cost and the selling price of the assets; that is to say, in the case of a sale, book values will be ignored save and except as such book values represent the actual cost of the properties.

Promissory Notes.

Where income is computed on the basis of actual receipts and disbursements, a promissory note is deemed payment of an account and is returnable as income. In the event that such note is not paid, it is deductible as a loss when actually ascertained to be worthless.

Property acquired by gift is not taxable, but the income accruing therefrom after receipt of such gift is income and subject to the tax. Property acquired by gift and thereafter sold at an advance of the value when gift was received, yields a profit of the difference between the selling price and such value, that is taxable as income. If such property was acquired prior to March 1, 1913, then the profit will be the difference between the selling price and the fair market value as at March 1, 1913.

Property Acquired by Gift. Legacies.

"Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates." This is true also of income from any kind of property held in trust, including that on accumulated income held in trust for the benefit of "unborn or unascertained persons, or persons with contingent interests and income held for future distribution under the terms of the will or trust." In such cases, except where the beneficiary makes the return, the executor, administrator or trustee shall make a return and be assessed on such income, less the exemption allowed to the estate during administration.

Income Received by Estates.

Where the beneficiaries receive the incomes from an estate, the respective shares to be distributed shall be the amounts returnable and subject to the tax.

Income to Heirs and Legatees.

> The general policy of the law and rule of interpretation require that legacies in all cases, unless clearly inconsistent with the intention of the testator, should be held to be vested rather than contingent. Where there is a vested interest the income from such interest, whether distributed or not, is subject to the tax; and when in the hands of fiduciaries they are required to account for and pay the tax thereon. (T. D. 2090.)

Legacies. Vested Interest.

In a case where a beneficiary sells securities at a price in excess of that at which such securities were appraised at the time of settlement of the estate, the increment constitutes a profit which is returnable as income by the beneficiary.

Profit Returnable by Legatee.

It has been ruled in a case where it was impracticable for the

executors to determine the net income and distributive share of the beneficiaries of a trust estate for over three years after the death of the testator that the executors may make fiduciary returns for the years 1913 to 1916, inclusive (if the interest of the beneficiary requires return to be made), and need not include the total amount in a return for the year 1916. Amended returns of the beneficiaries would be required if the distributive shares, added to income already returned in the years affected, would be subject to the additional or surtax.

Trust Estate Undistributed for Period of Years.

> "This office is in receipt of your letter, March 13, 1917, in which you advise that a resident of New York died in September, 1913, leaving a will by which he devised and bequeathed three-fourths of his estate to his three sons absolutely and one-fourth to a trust company in trust to pay the income therefrom to a daughter during her life, remainder to her issue; that it was impracticable for the executors to complete distribution of the estate or determine the amount of net income until 1916, when an account was prepared showing the net income accruing to each beneficiary during the last three months of 1913 and during the years 1914 and 1915, and that a large part of the accumulated income was distributed in 1916. You ask if this office will permit the daughter (beneficiary under the trust) to amend her returns for 1913, 1914 and 1915 and include in each the amount of income accrued to her and to which she was entitled in the year for which the return was made but which was not actually determined or received by her until 1916, or whether she will be required to include the total amount received in her return of income for 1916. You state that if the income so distributed be spread over the years 1913 to 1915, inclusive, that the amount distributed for any one of these years will be less than $20,000 but that taken together the amount would exceed $20,000. From the foregoing statement, it would appear that the facts of the case bring it within the prescription of the Treasury Decision 1943 and that, although the beneficiaries were determined, not until 1916, did the settlement of the estate reach the stage where the respective interests in the income derived from the estate were determinable. The executors should make a fiduciary return for each of the

years 1913, 1914, 1915 and 1916, reciting therein the respective beneficiaries and their interests, if the interest of any beneficiary subject to withholding of normal tax by the fiduciary, was $3,000 or over, and for 1916 if the amount paid or payable to any beneficiary from the amount shown on line 3, page 1 of the return, Form 1041, was $3,000 or over. In all cases when the amounts so distributed for each of the years 1913 to 1916, inclusive, added to other income of the beneficiaries, would make the income of such beneficiaries subject to the additional tax, said beneficiaries should make amended returns and include therein the amount received for the years noted. If all tax for which the beneficiaries are liable shall have been paid, amended returns will not be required for the years 1913 to 1915, inclusive. For the year 1916, return must be made when the interest of a beneficiary is $3,000 or over, even though there is no tax liability, and for this reason amended returns should be made for the year 1916." (Letter to the Corporation Trust Company, signed by Acting Commissioner David A. Gates, and dated March 24, 1917.)

Insurance Agents.

It has been held that commissions received on renewal premiums are taxable income in the year received by the agent. (Edwards *v.* Keith, 224 Fed. 585. Affirmed, United States Circuit Court of Appeals, 2d Circuit, 231 Fed. 110.)

A premium on a policy of insurance on the life of an insurance agent received by him on account or in payment of commissions due him, in lieu of cash, is deemed to be income to the amount of premiums so received.

Rentals Received.

Ordinarily, rent should be included in the return of the landlord for the year in which it is received, regardless of when it accrued or became due. If the accounts of the landlord are kept upon the accrual method, i. e., charging the tenant with the amount of rent on the due date thereof, and crediting the same to Income from Rents, then the return may be made on that basis. Items so charged that are found to be uncollectible, may be deducted as bad debts for the period in which the same prove to be uncollectible.

Interest upon the obligations of a State, or any political subdivision thereof, or upon the obligations of the United States

Interest on Government Obligations not Taxable.

or its possessions, or securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916, are exempt, by law, from the income tax except as to obligations issued by the United States after September 1, 1917, which are exempt "only if and to the extent provided in the act authorizing the issue thereof."

Political Subdivision Defined.

Under the Act of 1913, which contained the same language as the present law with respect to the exemption of "interest upon the obligations of a State or any political subdivision thereof" it was ruled that:

> . . . Special assessment districts created under the laws of the several States for public purposes, such as the improvement of streets and public highways, the provision for sewerage, gas and light, and the reclamation, drainage or irrigation of bodies of land within such special assessment districts when such districts are for public use, are political subdivisions of the State within the meaning of the above proviso.
>
> It is held that the term "political subdivision" includes special assessment districts or divisions of a State created by the proper authority of the State acting within its constitutional powers and under its general laws, for the purpose of carrying out a portion of those functions of the State which by long usage and inherent necessities of government have always been regarded as public.
>
> Levee and school districts, when lawfully created under the authority of the State and which are authorized by the laws of the State to levy a tax to meet the obligations of such districts, are also held to be political subdivisions of a State within the meaning of the Income Tax Law.
>
> The income derived from interest upon the obligations of all such public districts shall, therefore, be excluded in computing net income for the income tax. (T. D. 1946.)

Contractor Doing Work for State not Exempt.

An individual who enters into a contract with a State, or any political subdivision thereof, for the construction of a public highway, is held not to be an officer or employee of the said State or a political subdivision thereof, and, therefore, the amounts received by him from the State or a political subdivision thereof, under the terms of the contract, are not exempt from tax

under the provisions of the Federal income tax law, and should be included in any return of annual net income he may be required to render. (T. D. 2152.)

The first issue of "Liberty Loan" bonds, authorized by act of Congress approved April 24, 1917, "15/30 Year 3½% Gold Bonds," are exempt both as to principal and interest from all taxation, except estate and inheritance taxes imposed by authority of the United States or its possessions, or by any State or local taxing authority. **Interest Liberty Bonds 3½%.**

The second issue of "Liberty Loan" bonds, authorized by act of Congress approved September 24, 1917, "10/25 Year 4% Convertible Gold Bonds" are wholly exempt as to the normal tax under the Act of September 8, 1916, but as to the additional income taxes (surtaxes) and excess-profits taxes and war-profits taxes only to the amount of interest on bonds and certificates, the principal of which does not exceed in the aggregate $5,000, owned by any individual, partnership or corporation. **Interest Liberty Bonds 4%.**

It has been ruled that each member of a family is entitled to the exemption of interest on bonds aggregating, in principal, $5,000, as per the following telegraphic inquiry and reply:

> "Please answer by wire at once if possible our telegram October second, as follows: 'If husband, wife and minor children each hold new Liberty fours and make joint income tax return will each member of such family be tax exempt as to $5,000 bonds each. Wire answer today if possible.'" (Answer) "Husband and wife each owning in own right Liberty Loan Bonds and certificates not exceeding five thousand dollars each entitled to exemption provided by Section Seven B, Loan Act. Minor children having separate estates each entitled to same exemption." (Telegram to Commissioner of Internal Revenue from Lee, Higginson & Co., Boston, Mass., and the reply thereto, signed by Acting Secretary of the Treasury, O. T. Crosby, and dated October 8, 1917.)

The following Treasury Decisions have been issued for the guidance of Government officers and employees as to what constitutes income and deductible expenses; when *per diem* charges in lieu of subsistence may be charged. **Income and Expenses of Government Employees.**

Quarters: Commutation of quarters and the money equivalent of quarters furnished in kind shall be returned as income.

When quarters are furnished in kind, of a less number of rooms than the number allowed by law, the money equivalent only of the number of rooms actually assigned shall be returned as income. When quarters are furnished in kind, of a greater number of rooms than the number allowed by law, it is to be assumed that the excess number is assigned for the convenience of the Government, and the money equivalent only of the number of rooms allowed by law shall be returned as income.

Heat and light: Amounts received by, or paid for, an officer for heat and light shall be returned as income.

This includes the money equivalent, as fixed by the Government, of heat and light furnished to an officer occupying public quarters.

Mileage: The difference between the amount received as mileage and the amount of actual necessary expenses incurred on a journey shall be returned as income.

Mileage, as such, is not gain, profit, or income to the officer, as he is required to pay his actual expenses while traveling under mileage orders. The gain, profit, or income is the difference between the amount received as mileage and the amount properly expended by the officer while traveling; and this difference, only, should be returned as income.

The actual expenses to be deducted by the individual before ascertaining his gain, profit, or income on account of mileage are the expenses for which reimbursement would be made by the Government if he had traveled on an actual expense basis instead of a mileage basis.

Reimbursement for actual expenses: Amounts paid by the Government in the nature of reimbursement for subsistence and other items of actual expenses incurred while absent on business for the Government are not required to be returned as income.

Per diem allowances in lieu of subsistence while traveling under orders: The difference between the amount received as a *per diem* allowance and the amount of actual necessary expenses incurred on a journey shall be returned as income. (T. D. 2079.)

Reference is made to Mim. 1078, dated August 27, 1914,

requiring revenue agents and inspectors paid from the appropriations "Collecting the Income Tax" to modify their Forms 132 for August, 1914, and thereafter to report "headquarters" instead of "legal residence," the "headquarters" being the home—the actual domicile of the officer.

There has been so much confusion resulting, and so many officers have attempted to change their homes for the purpose of enabling them to receive *per diem* in lieu of subsistence, that it is found to be necessary to issue the following instructions as supplemental to the mimeograph above cited.

The Act of August 1, 1914, provides that heads of executive departments may prescribe within limits *per diem* in lieu of subsistence to persons traveling on duty away from their designated posts of duty when not otherwise fixed by law.

The Comptroller of the Treasury has ruled that headquarters may be established as the designated posts of duty of the agents and inspectors whose *per diem* in lieu of subsistence is not fixed by law—that is, they will be considered as in a travel status when on duty away from their headquarters.

With the Comptroller's ruling in view, the headquarters of the officers referred to have been fixed at their homes.

When a particular place has been reported by an agent or inspector as his home when commissioned, he cannot thereafter report his home or headquarters elsewhere for the purpose of claiming *per diem* in lieu of subsistence, without first obtaining the permission of the Commissioner of Internal Revenue. This does not mean that a home may be established elsewhere than the place originally reported as headquarters and *per diem* in lieu of subsistence claimed when within the confines of the new or most recent home, as that would be a perversion of the law and the regulations made to carry the law into effect. In other words, when a particular place is reported as home, such place will continue as a home until actual domicile is taken up elsewhere, and when that is done or contemplated being done, the Commissioner should be fully advised of the change or proposed change, the reason therefor set forth in full and permission requested to report the new abode as "headquarters" on Form 132. If the Commissioner approves, a

new commission will issue, and, if he does not approve, the agent or inspector, as the case may be, will not charge *per diem* in lieu of subsistence when he is at or within the confines of his home as at first reported or his actual home established thereafter, as under no circumstances can *per diem* in lieu of subsistence be paid when such agent or inspector is at or within the confines of his actual home. (T. D. 2124.)

Rates of Exchange. Foreign Investments.

Income on foreign investments accrued abroad to an American citizen, placed to his credit but not remitted, may be reported as income at the rate of exchange prevailing at the time that such income was credited abroad.

"This office acknowledges receipt of your letter of January 4, 1916, wherein you cite the case of a resident American citizen who had accruing to him from time to time income from foreign investments which was not remitted to the United States but was placed to his credit in different foreign countries, and request to be advised whether in computing income tax liability it will be proper to use the rates of exchange prevailing at the time the amounts were credited abroad.

"In reply you are advised that, in the case cited, it will be proper for the individual to return each item of income at the rate of exchange which prevailed on the date it was credited to his account." (Letter to Herbert M. Teets, New York, N. Y., signed by Deputy Commissioner L. F. Speer, and dated January 11, 1916.)

This practice would be inadvisable, however, in the case of foreign branches of American concerns. Under the present abnormally high rates of exchange it would be unwise to charge a branch office with the profit reported by it at the current rates. The simplest method, and probably the easiest of adjustment, is to adopt a fixed rate of exchange for each branch or foreign country by which rate all credits and charges to branch accounts are made. As funds are transmitted to the United States adjustment is made as between the assumed rate and the rate paid. The fairness of this method is obvious, in that it does not reflect in the books of account radical fluctuations in exchange, and, from a bookkeeping point of view,

renders the reconciliation of main and branch office accounts comparatively simple.

Interest on bank balances is returnable in the year credited by the bank. **Interest on Bank Account.**

(Interest on bank deposits or on certificates of deposit) whether paid or accrued and unpaid, must be included in the annual income return of the person entitled to receive such interest, whether on open account or on the certificate of deposit. (Art. 67, Reg. 33.)

Oftentimes interest is not all credited within the calendar year to which it applies. There is no obligation on the part of the taxpayer to accrue the uncredited portion unless his return is made on the accrual basis.

Pensions received from the United States Government are subject to the income tax. (T. D. 2090.) **Pensions.**

According to Treasury Decision 2090, payments of alimony are regarded as personal expenses of the payer and the recipient is required to report the same as income. This resulted in a double tax, in that the payment was not deductible by the payer and yet the recipient paid an income tax thereon. The United States Supreme Court, in an unreported case, has held that alimony is not income and is, therefore, not subject to an income tax. **Alimony not Income.**

The principles governing the payment and receipt of alimony are also true in a case where the husband and wife, under an agreement of separation, live apart and where the husband, pursuant to such agreement, pays the wife a fixed annual sum. If the wife is required under the law to make a return, she is not required to include therein the amounts received from her husband under such agreement.

All individuals, partnerships and corporations making a business of collecting foreign payments of interest or dividends by means of coupons, cheques or bills of exchange, are required to obtain a license from the Commissioner of Internal Revenue and are subject to such regulations in the conduct of their business as the Commissioner may prescribe. Violation of the provision of law in respect of the requirement of a license to do **License Required by Collectors of Foreign Income.**

such business is punishable as a misdemeanor, and for each offense subjects the offender to a fine of $5,000 or imprisonment for one year, or both, in the discretion of the court. [Law, Section 9 (d).]

Foreign Income of Non-resident Aliens. Income from foreign investments such as dividends on stock of foreign corporations received by nonresident aliens is not taxable and is not required to be included in a return of net income.

Record Owner not Actual Owner of Stock. Non-resident Alien. Where capital stock of a domestic corporation is registered in the name of a citizen of, or resident alien in, the United States, or a domestic firm or corporation, but the actual owner of such stock is a nonresident alien individual, firm or corporation, it is necessary that the owner of record disclose to the Commissioner of Internal Revenue the name and address of the actual owner by filling out and filing with the Collector of Internal Revenue form No. 1087, revised.

The intent and purpose of this regulation is to provide only in respect of making return for and payment of tax on dividend income accruing to nonresident aliens.

Such dividends on stock of domestic corporations or resident alien corporations are held, *prima facie*, to be income to the record owner of the stock and such record owner will be liable for the income tax, normal or additional, according to his or its individual or corporate status, unless a disclosure of actual ownership is made to the Commissioner of Internal Revenue which shall show who the actual owner is and his address, and that the record owner is not the actual owner. This showing shall be made upon the form herein provided.

When the record owner of such stock is a nonresident alien corporation, etc., not having an office or place of business in the United States, the debtor corporation will withhold the normal income tax and pay the same to the proper officer of the United States authorized to receive it in manner and form provided for withholding and accounting for tax withheld.

In all cases where the actual owner is a nonresident alien individual or corporation and the record owner is an individual, firm, or corporation in the United States, citizen,

or resident alien, and the aforesaid showing of actual ownership is made, the record owner will be held, for income tax purposes, to have the receipt, custody, control and disposal of the dividend income and will be required to make return for the actual owner and pay the tax found by such return to be due. Where the actual owner is a nonresident alien corporation return will be made regardless of the amount of dividend and the normal income tax will be paid; and when the actual owner is a nonresident alien individual a return shall be made whenever the amount of dividend is $3,000 or over; and when the net amount thereof exceeds $20,000 said custodian shall also pay the additional tax on such income. The return for nonresident alien corporations shall be made on Income Tax Form 1031 (1030 for insurance companies), and return for nonresident alien individuals shall be made on Income Tax Form 1040.

When it shall appear from the disclosure herein provided for that the actual owner is a nonresident alien partnership all certificates making such disclosure shall be transmitted to the collector for the information of the Commissioner of Internal Revenue, but no return will be made for such partnership and no amount will be retained from such income by the representative of such partnership in the United States unless and until said representative shall be so instructed by the Commissioner of Internal Revenue.

The term "corporations" as used above covers corporations, joint-stock companies or associations, and insurance companies. The term "nonresident alien corporations" covers all corporations, joint-stock companies or associations, and insurance companies organized, authorized, or existing under the laws of a foreign country and having no office or place of business in the United States; the term "resident alien corporations," such foreign organizations as have an office or place of business in the United States. (Extract from T. D. 2401.)

As stated in T. D. 2401 (*ante*), a stockholder of record is, *prima facie*, held to be the actual owner, and accountable for taxes thereon. Where the actual owner is a citizen or resident of the United States the record owner is not required to file any certificate nor is he obliged to include dividends on stock so held in his personal return. Upon inquiry, in such case,

the record owner must show conclusively that he is not the actual owner.

"This office has before it your letter of October 25, 1916, wherein you refer to T. D. 2382 (amended by T. D. 2401) and request to be advised what form of certificate, if any, should be executed by a record owner of domestic stock, the actual owner of which is a citizen or resident of the United States. In reply you are advised that, under the Federal Income Tax Law of October 3, 1913, the withholding provisions of which, in so far as they relate to the taxibility of dividends on domestic stocks when paid to citizens or residents of the United States, are the same as those set forth in the Income Tax Law of September 8, 1916, it was not found necessary that a certificate should be filed by a record owner of stock when the actual owner was a citizen or resident of the United States, and no such certificate was required, and, therefore, none will be required under the provisions of the act of September 8, 1916. The primary purpose of the certificate provided by Treasury Decision 2382 is to assist in securing a proper administration of the provision of the Act of September 8, 1916, which makes dividends on domestic stocks subject to income tax, and to withholding of normal tax at the source, when paid to a foreign company, corporation, joint-stock company or association or insurance company having no office or place of business in the United States.

"The record owner of stocks is not required to include in his or its own income tax return any amount of dividends received on stocks that actually belong to another, but if a question should be raised as to why dividends on stocks recorded in the name of an individual, firm or corporation are not included in the record owner's income tax return, such owner will be required to show conclusively that the actual ownership of the stocks rested with another." (Letter to Lee, Higginson & Company, Boston, signed by Commissioner W. H. Osborn, and dated November 21, 1916.)

VII. Farms and Farmers

Farms and Farmers Defined.

"The term 'farm' as herein used embraces the farm in the ordinary accepted sense, plantations, ranches, stock farms, dairy farms, poultry farms, fruit farms, truck farms and all lands used for similar purposes; and for the purposes of this decision all persons who cultivate, operate

or manage farms for gain or profit, either as owners or tenants, are designated as 'farmers.'

"All gains, profits, and income derived from the sale or exchange of farm products, whether produced on a farm or purchased and resold by a farmer, shall be included in the return of income for the year in which the products were actually marketed and sold; and

Income from Farms.

"All allowable deductions, including the legitimate expenses incident to the production of that year or future years, may be claimed in the return of income for the tax year in which the right to such deductions shall arise, although the products to which such expenses and deductions are incidental may not have been sold or exchanged for money; or a money equivalent, during the year for which the return is rendered.

Prepaid Farm Expenses Deductible.

"Rents received in crop shares shall likewise be returned as of the year in which the crop shares are reduced to money or a money equivalent, and

Farming on Shares.

"Allowable deductions, likewise, shall be claimed in the return of income for the tax year to which they apply, although expenses and deductions may be incident to products which remained unsold at the end of the year for which the deductions are claimed.

Farm Expenses Deductible in Year Paid.

"When farm products are held for favorable market prices, no deduction on account of shrinkage in weight or physical value, or losses by reason of such shrinkage or deterioration in storage, shall be allowed.[1]

Loss in Value of Farm Products Held for Advance.

"Cost of stock purchased for resale is an allowable deduction under the item of expense, but money expended for stock for breeding purposes is regarded as capital invested, and amounts so expended do not constitute allowable deductions except as hereinafter stated.

Live Stock Purchased.

"Where stock has been purchased for any purpose, and afterwards dies from disease or injury, or is killed by order of the authorities of a State, or the United States, and the cost thereof has not been claimed

Loss by Death of Live Stock Deductible.

[1] By ruling (T. D. 2609) of Dec. 19, 1917, inventories may be valued at cost or at cost or market, whichever is the lower. (See page 167.)

as an item of expense, the actual purchase price of such stock, less any depreciation which may have been previously claimed, may be deducted as a loss. Property destroyed by order of the authorities of a State, or of the United States, may, in a like manner, be claimed as a loss.

Receipts for Condemned Live Stock.

"But if reimbursement is made by a State or the United States, in whole or in part, on account of stock killed or property destroyed, the amount received shall be reported as income for the year in which reimbursement is made.

Farm Machinery not Deductible.

"The cost of farm machinery, is not an allowable deduction as an item of expense, but the cost of ordinary tools may be included under this item.

Depreciation Allowed on Farm Property.

"Under the sixth deduction enumerated in Paragraph 'B,' providing for 'a reasonable allowance for the exhaustion, wear, and tear of property arising out of its use or employment' . . . , there may be claimed a reasonable allowance for depreciation on farm buildings (other than a dwelling occupied by the owner), farm machinery, and other physical property, including stock purchased for breeding purposes; but no claim for depreciation on stock raised or purchased for resale will be allowed.

Farmers' Books of Account.

"Farmers who keep books, according to some approved method of accounting, which clearly show the net income, may prepare their returns from such books, although the method of accounting may not be strictly in accordance with the provisions of this decision.

Farm Maintained Only for Recreation.

"A person cultivating or operating a farm, for recreation or pleasure, on a basis other than the recognized principles of commercial farming, the result of which is a continual loss from year to year, is not regarded as a farmer. In such cases, if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from sale of products may be ignored in rendering a return of income; and the expenses incurred being regarded as personal expenses will not constitute allowable deductions in the return of income derived from other sources." (T. D. 2153.)

VIII. Deductions Allowed Individuals

Personal Exemptions.

The specific or personal exemptions, deductible under the Act of September 8, 1916, and the Act of October 3, 1917, are as follows:

	Act of 1916	*Act of 1917*
To unmarried persons	$3,000	$1,000
To married persons or heads of families	4,000	2,000
To heads of families for each dependent child under the age of 18 years or if incapable of self-support because mentally or physically defective; allowed only to one parent of the same family	200	200
To guardians and trustees for each ward or *cestui que trust*, if		
Unmarried	3,000	1,000
Married	4,000	2,000
To estates of deceased persons (citizens and residents) during period of administration where income is not distributed	3,000	1,000

By amendment of law a nonresident alien receives no personal exemption.

Single or Married Status.

The single or married status of a person at the close of the year determines the amount of the personal exemption.

Salaries Exempt.

Salaries of the following are exempt from income tax:

President of the United States during the term for which he has been elected;

Judges of the Supreme Court and inferior courts of the United States now in office;

Officers and employees of a State, or any political subdivision thereof,[1] but not when paid by the United States Government.

Dividends Creditable.

For the purpose of computing the normal taxes (2 per cent. under the Act of 1916 and 2 per cent. under the Act of 1917) the amount of dividends received upon stock or from net earnings of corporations or associations, which are themselves taxable upon their net income, are deductible from the total net income from all sources; that is to

[1] Income received by such persons from other sources is subject to tax and must be reported.

say, such dividends or earnings are only subject to additional or surtaxes.

Tax Withheld Creditable. The amount of normal taxes withheld at the source of payment are deductible in the return of the individual entitled to credit therefor.

Necessary Business Expenses Deductible. A citizen or resident of the United States in computing his net income is allowed as deductions from gross income, all necessary expenses paid in carrying on his business or trade. Personal, living, or family expenses are not deductible. [Law, Section 5 (a) First.]

Interest Deductible. All interest paid within the year on the indebtedness of the taxpayer, except that incurred for the purchase of obligations or securities the interest upon which is exempt from income taxes. [Law, Section 5 (a) Second.]

Interest Incurred in Purchase of Liberty 4's. Interest paid within the year on indebtedness incurred in the purchase of 4 per cent. Liberty Bonds (Second Issue) is deductible in computing net income subject to income, war income and excess profits taxes. (T. D. 2541.)

Accrued Interest on Bonds Purchased. The amount of accrued interest paid by a purchaser of bonds to the seller should be deducted from interest received upon the bonds after they were purchased. That is to say, the bondholder should only account as income for the interest received by him in excess of the accrued interest paid to the vendor. The amount of interest paid to the vendor will be accounted for as income received by him.

Contributions to Charities. Contributions or gifts actually made within the year to charitable institutions existing as corporations or associations and organized and operated exclusively for religious, charitable, scientific or educational purposes, or to societies for the prevention of cruelty to children or animals, are deductible to an amount not in excess of 15 per cent. of the taxpayer's taxable income exclusive of the amount of contributions to such charities.[1] Contributions or gifts that inure to the benefit of any private stockholder or individual are not deductible.

All taxes are deductible except income and excess profits

[1] This deduction may only be made by individuals; the provision of law is not applicable to corporations.

taxes paid, and assessments for local benefits. Excess profits tax assessments are deductible, however, as a credit in computing the amount subject to income taxes. **Taxes.** The effect of this provision in respect of the excess profits tax where the return is based on receipts and disbursements is even more favorable to the taxpayer than the deduction of "taxes paid" under the old law, because the taxpayer receives the benefit of the deduction in the period upon which the tax is computed, instead of, in the return for the period in which the tax was paid, as heretofore. [Law, Section 5 (a) Third.]

Taxes paid in the nature of local benefits, such as grading, paving, sidewalks, sewerage, etc., are not deductible. These are deemed to be capital expenditures on the theory that the improvement increases the value of the property affected thereby. **Local Assessments not Deductible.**

Water rates on business or rented property may be deducted as "necessary expenses." They should not be deducted as taxes. **Water Rates.**

Payments by an employer to the family of a deceased person, in the form of a gratuity, are not deductible from the return of the employer; on the other hand, it is not required that the amount of such payments shall be included in the return of the payee. **Pension.**

> Where the monthly salary of an officer or employee is paid for a limited period after his death to his widow in recognition of the services rendered by her husband, no services being rendered by the widow, it is held that such payment is a gratuity and exempt from taxation under the Income Tax Law. Such a payment would not, however, be an allowable deduction as an expense of carrying on business in the return of the person, firm, or corporation paying same. (T. D. 2090.)

Where an employee pays the cost of a fidelity bond incident to his employment, he may deduct the cost thereof. **Premium on Fidelity Bond.**

Losses sustained during the year which are not compensated for by insurance or otherwise, including those arising from fires, storm, shipwreck, or other casualty are deductible. **Losses.**

> Loss to be deductible must be an absolute loss, not a speculative or fluctuating valuation of continuing investment, but must be an actual loss, actually sustained and ascertained during the tax year for which the deduction is sought to be made; it must be determined and ascertained upon an actual, a completed, a closed transaction. (T. D. 2005.)
>
> A loss is none the less actual because an individual can not divest himself of the possession of worthless stock by sale, but that condition alone does not give the loss in question such a character as appears to the department to have been contemplated by the Income Tax Law.[1] (T. D. 2135.)

Loss Defined.

By rulings of the Treasury Department, loss has been defined as the difference between the selling price and the cost, where the selling price is less than the cost. In cases where the property was acquired prior to March 1, 1913, however, the measure of "cost" is the market value as of that time. (See page 34.)

Losses not in Business or Trade.

Under the old income tax law (1913) the deduction of losses sustained outside of the taxpayer's business or trade were not deductible. He was required to account for profits and income from all sources, but was prohibited from deducting any losses not incurred in trade. The amended law, however, provides that in "any transaction entered into for profit, but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom" are deductible. It has been held by the Treasury Department that losses not sustained "in trade" may only be deducted "to an amount not exceeding the profits derived from similar transactions." This provision would apply to stock speculations, real estate operations and any speculative venture which is not embraced in the ordinary business or trade of the taxpayer. [Law, Section 5 (a) Fifth.]

Losses in One Trade Deductible from Income of Another.

Where a person is engaged in more than one trade or business the loss sustained in one is deductible from the profit of the other; but the person must be actually engaged in the businesses or trades.

[1] This ruling does not apply to dealers in securities. See page 167.

A person must have more than one business in the sense of being engaged in more than one trade, and may deduct losses incurred in all of them, provided that in each trade it can be clearly shown that he is actually a dealer, or trader, or manufacturer, or whatever the occupation may be.

Neither the investment by an individual of money in the stock of a company nor the employment by the company of his services in any official capacity can serve to make the business in which the company was engaged a matter of his individual trade. (T. D. 2135.)

In Trade Defined.

"'In trade' is synonymous with business. "Business" has been defined as—

"That which occupies and engages the time, attention and labor of any one for the purpose of livelihood, profit or improvement; that which is his personal concern or interest; employment, regular occupation, but it is not necessary that it should be his sole occupation or employment.

"The doing of a single act incidentally or of necessity, not pertaining to the particular business of the person doing the same, will not be considered engaging in or carrying on the business." (T. D. 1989.)

Bad Debts Deductible.

Debts due to the taxpayer actually ascertained to be worthless and charged off within the year, are deductible. (See "Bad Debts," page 213.)

Depreciation Deductible.

A reasonable allowance for the exhaustion, wear and tear of property, arising out of its use or employment in the business or trade, is deductible.

In order to render depreciation deductible it must be entered in the books of account in such way that it effects a reduction of the asset account to which it is applicable. This may be accomplished by establishing a Reserve for Depreciation Account or by actual reduction of the asset account itself. The preferable method is to create a reserve account, except, perhaps, with respect to properties that are replaced often.

When the depreciation deducted equals the cost of property depreciated, or in case of a purchase prior to March 1, 1913, the fair market value as of that date, then no further deduction will be allowed. (See Chapter VI, on Depreciation, page 175.)

Depreciation. Stocks Bonds.

The depreciation referred to in the Income Tax Law does not relate to evidence of a right or interest in property and hence, any shrinkage in the value of bonds, stocks, and like securities, due to fluctuations in their market value, is not deductible in a return of income as depreciation or loss.[1] (T. D. 2005.)

Depletion Oil and Gas Wells.

"In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow" is a deductible item. When such allowance, however, aggregates the capital originally invested, or in case of purchase prior to March 1, 1913, the fair market value as of that date, then no further allowance for depletion will be deductible.

Depletion of Mines.

A reasonable allowance for depletion of mines is deductible, not to exceed, however, the market value in the mine of the product thereof, which has been moved and sold during the year for which the return and computation are made. As in the case of oil and gas wells, no further allowance for depletion will be allowed when the aggregate thereof equals the capital originally invested, except that in case the property was acquired prior to March 1, 1913, then no deduction will be allowed in excess of the fair market value of the property as of that date.

Improvements not Deductible.

No deduction is allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of its property.

Restoring Property Not Deductible.

No deduction is allowed for amounts expended to restore property or for making good the exhaustion thereof for which an allowance is or has been made. (See page 183.)

Replaced Buildings.

A loss sustained by the voluntary removal of a building, for the purpose of erecting one more modern, is not deductible from a return of net income, but such loss may be added to the cost of the new building.

Where a dilapidated building is taken down by order of a building department of the Government, acting under au-

[1] A dealer in securities, however, may inventory the same at cost or at cost or market price, whichever is the lower. (T. D. 2609.)

thority of a statute, because such building is a menace to public safety, the owner thereof for the loss sustained might under some circumstances, be entitled to a deduction of the difference between the cost of the building (exclusive of land) and a reasonable allowance for depreciation for the years of its existence.[1]

Buildings Taken Down by Order of Government.

The test as to the deductibility of an amount paid in compromise or settlement of a claim, or cause of action, for personal injuries is, whether the liability was incurred "in trade." A payment in settlement of a suit for injuries caused by a delivery truck of a corporation or individual used "in trade" would be deductible, whereas, damages paid for injuries caused by the private automobile of an individual would not be deductible.

Damage Suits. Judgment.

A reserve or fund set aside by either an individual or corporation for insurance purposes is not a deductible item. But an actual loss sustained and charged to such reserve or fund may be deducted.

Insurance Reserve or Fund not Deductible.

Fire insurance premiums on a rented dwelling, not occupied by the owner, are deductible.

Fire Insurance Premiums.

Commission paid to a real estate agent for collecting rents and management of property is an allowable deduction.

Commissions Real Estate Agent.

Contributions to the campaign expenses of a political party have been held not to be deductible from income.

Political Campaign Expenses.

Any expenses which may be incurred in connection with the procurement of nontaxable income, are not deductible items.

Expense on Account Non-Taxable Income.

> Expenses incurred in earning income which is not subject to tax under the income tax law do not constitute allowable deductions in computing net income from other sources which are taxable under the law. (T. D. 2137.)

It is not unusual for insolvent corporations in the course of reorganization to assess the stockholders a fixed sum for

[1] Make application for special ruling, supported by affidavit stating the circumstances of the case, amount of loss, and how computed.

Assessment of Stock. each share of stock held, the proceeds of which are used in the reëstablishment of the defunct company. Payments of such assessments by stockholders may not be stated as expenses incurred; they are investments of capital and do not constitute allowable deductions.

Taxes Paid by Tenant. Taxes paid by a tenant to a landlord may be treated as rent paid and are deductible as an expense of doing business. (T. D. 2090.)

Life Insurance Premiums. Life insurance premiums paid by the insured do not constitute allowable deductions under the income tax law. (T. D. 2090.)

Inheritance Tax. Collateral inheritance taxes levied under the laws of the State of New York are not such taxes as are deductible in computing the income tax of an estate or a beneficiary. Such taxes are deemed to be a charge against the corpus of the estate and not against the income thereof.

Taxes on Stock Paid by Bank. Tax assessments against its stockholders, paid by a bank for their account, are not deductible from the return of the bank. Such taxes are, however, deductible by the stockholder but must be included in the stockholder's return as income. The amount so included in the return, should be stated as dividends received, on the income side, and under deductions as taxes paid.

> Taxes assessed against the stockholders of a bank and paid by the bank in behalf of the stockholders do not constitute an allowable deduction from the gross income of the bank, but do constitute an allowable deduction in the return of the individual. If such individual is subject . . ., the amount of taxes so paid should be included in his return as income, the said amount being considered as an additional dividend to the amount of the taxes paid. (T. D. 2135.)

Where there has been a change of ownership of stock subject to such tax assessment during a taxable year, it has been ruled that the owner thereof at the time that the assessment becomes payable is the party who is entitled to the deduction.

Customs duties paid during the year are proper deductions from an income tax return and may be treated as taxes paid, or in the case of a taxpayer being engaged in the business of importing it may be added to the cost of the merchandise.

Customs Duties.

In case of an erroneous or illegal assessment and collection, the taxpayer should appeal [1] at once to the Commissioner of Internal Revenue. If the Commissioner fails to respond within six months after such appeal is made, suit for recovery may be brought; but whether or not he responds, suit must be brought within two years after the action arose (date of assessment). In order to maintain such action it must be shown that payment was made under protest [1] and duress or coercion. No particular form of protest is required, and to constitute duress or coercion, the mere receipt of a notice containing a threat to exercise the power possessed by the Government or its agent against the person or property of the taxpayer is sufficient. The taxpayer has no means of relief except by payment.

Protest.

Statute of Limitations.

[1] Copies of appeal and protest should be retained by the taxpayer to be used as matter of proof in Court of Claims.

CHAPTER II

WITHHOLDING TAX

The provisions of the Act of September 8, 1916, requiring the withholding of normal tax at the source of payment were ma-

Amended Law. terially amended by the Act of October 3, 1917. Under the present law withholding is not required except as follows:

(1) All persons, partnerships, corporations, joint-stock companies, associations or insurance companies, in whatever ca-

Nonresident Alien Individuals pacity acting, as lessees, mortgagors, trustees, executors, administrators, receiver, or employers and all officers and employees of the United States, having the custody, disposal or payment of interest, rent, salaries, premiums, compensation or other fixed or determinable annual or periodical gains, profits or income of

Nonresident alien individuals,

except income derived from dividends or net earnings of corporations which are taxable upon their net income, are required to deduct and withhold the normal tax of 2 per cent. thereon (Law, Section 9 [b]); such withholding is required regardless of amount of income.

(A nonresident alien is entitled to no personal exemption under present law, and no deductions except by making and filing a true and accurate return of income received from sources within the United States, by February 1st.)

Income of Nonresident Foreign Corporations. (2) The normal taxes of 6 per cent. (2 per cent. under Act of 1916 and 4 per cent. under Act of 1917) must be deducted and withheld from incomes derived from sources within the United States by:

Nonresident foreign corporations not engaged in business or trade within the United States and having no office or place of business therein,

from interest upon bonds and mortgages or deeds of trust or

similar obligations of domestic or resident corporations, associations and insurance companies.

Section 13 (e) purports to include in the foregoing provision "nonresident alien firms, copartnerships and companies" but the tax subject to be withheld is limited to the normal tax on corporations in the following language: "shall be made applicable to the tax imposed by subdivision (a) of section ten." By reason of this defect in the law, the Commissioner of Internal Revenue has directed that there shall be no withholding against any form of income of foreign copartnerships, as indicated in the following ruling:

> "With reference to your telegram of October 15, 1917, and office reply of October 16, 1917, you are now advised that under the provisions of the Federal Income Tax Law of September 8, 1916, as amended by the War Revenue Act of October 3, 1917, no form of income derived from sources within the United States by a foreign co-partnership having no office or place of business in the United States is subject to the withholding of normal income tax at the source. Therefore, the Southern Pacific Company is not required to withhold normal income tax from any amount of interest paid on its bonds to such foreign co-partnership." (Letter to Gordon M. Buck, General Counsel, Southern Pacific Company, signed by Commissioner Daniel C. Roper, and dated October 26, 1917.)

(Nonresident foreign corporations are entitled to no specific exemption, and no deductions unless returns are filed by February 1st.)

Dividends to Nonresident Alien Companies.

(3) The normal tax of 2 per cent. shall be deducted and withheld from incomes derived from sources within the United States by:

Nonresident alien companies, corporations, associations and insurance companies not engaged in business or trade within the United States and having no office or place of business therein,

from dividends upon the capital stock or from the earnings of

domestic or resident corporations, associations or insurance companies. [Law, Section 13 (f).]

> "Corporation is to pay dividend to non-resident alien corporations not engaged in business or trade within the United States and not having any offices or places of business therein. Shall paying corporation deduct two per cent or shall it deduct six per cent leaving foreign corporations to make returns on which credit for dividends for extra four per cent may be shown and then claim refund of extra four per cent? Please telegraph decision our expense." (Answer) "Domestic corporation paying dividend to foreign corporation having no office or place of business in United States should withhold two per cent only." (Telegram from the Corporation Trust Company to Commissioner Daniel C. Roper and his reply thereto dated October 29, 1917.)

Tax Exempt Clause.

(4) The normal tax of 2 per cent shall be deducted and withheld from payments of interest upon bonds and mortgages, deeds of trust or other similar obligations of corporations, joint-stock companies or associations or insurance companies "if such bonds, mortgages or other obligations contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed . . . upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States."

This provision of withholding is applicable to all interest payments on bonds and mortgages or deeds of trust of corporations containing the so-called "tax-free covenant" whereby the corporation agrees to pay the interest without deduction of tax. It applies to such interest whether the same is payable annually or at shorter or longer intervals and regardless of amounts, and is applicable to citizens, and residents of the United States and nonresident alien individuals. [Law, Section 9 (c).]

Section 3 of the War Income Tax provides that the war income normal tax of 2 per cent. shall not be withheld until on

and after January 1, 1918, and that thereafter only one 2 per cent. normal tax shall be withheld. The effect of this is that the obligor will pay 2 per cent. normal tax on all interest except where an exemption certificate is filed, and the obligee (Bondholder) receives credit for the 2 per cent. paid at the source and pays the additional taxes himself.

As already observed nonresident alien individuals are entitled to no exemption. Individual citizens and residents of the United States may obtain the benefit of exemption by filing with the withholding agent, on or before February 1st, a signed notice thereof in writing. [Law, Section 9 (c).]

Exemption.

Those required under the law to withhold taxes at the source of payment are required to make returns thereof on or before March 1st and to pay the amount withheld to the Collector on or before June 15th.

Returns of Taxes Withheld.

Those required to withhold taxes are made personally liable for the amount of the same, and they are, by law, indemnified against all persons, corporations, partnerships, associations and insurance companies for deductions from income required to be made.

Responsibility and Indemnity of Withholding Party.

All taxes heretofore withheld on income of citizens or residents, except from interest on bonds containing a "tax-free covenant" clause, by amendment of the Act of September 8, 1916, have been released and directed to be repaid to those entitled thereto.

Release of Taxes Withheld.

By amendment of the provisions of Act of September 8, 1916, with regard to withholding the normal tax at the source, on payments of income to citizens and residents of the United States, such withholding is no longer required except as to income from bonds containing the so-called "tax-free covenant" clause. There has been substituted in place of withholding in such cases a system of "Information at the Source," whereby it is required that all payments to taxable persons, partnerships or corporations during any taxable year, aggregating $800 or more for such year, must be reported to the Collector of Internal Revenue. Such return should be made for the calendar or fiscal year, as re-

Information at Source.

quired in respect of the income tax return, and should be filed at the same time.

"Information at the Source" is required in all cases where payments of rents, salaries and wages, commissions, interest, or any other fixed or determinable gains, profits and income aggregating $800 or more are made to a taxable person, partnership, corporation, or association. (Law, Section 28.)

It has been held that such return must be made irrespective of the basis upon which wages are computed and will include wages paid at piece-work rates.

> "Receipt is acknowledged of your letter dated October 15, 1917, requesting that you be advised whether the provisions of Section 28 added to the Act of September 8, 1916, by Section 1211, Act of October 3, 1917, apply to employers of workmen paid by the hour or by the piece, stating in this connection as follows:
>
> "'One of our clients employs some three thousand workmen who are almost all on piece work on an hourly basis and a large number of them will be paid more than $800 during the year. Their wages, however, are not fixed as would be a weekly or monthly salary, payments to them being variable from week to week and even from day to day.'
>
> (Answer) "In reply you are advised that in accordance with the provisions of the law as stated in the Section referred to above each person, corporation, partnership, etc., is authorized and required to render a true and accurate return to the Commissioner of Internal Revenue setting forth the amount of salary or compensation and the name and address of each employee who is paid $800 or more during the year 1917, and subsequent tax years. The liability for such return attaches in all cases of payments of salary or compensation amounting to $800 or more during the year, without regard to the basis of payment or the period during the year in which it was earned and for which it was paid." (Letter to Palmer and Serles, New York, N. Y., signed by Commissioner Daniel C. Roper and dated October 25, 1917.)

The required reports must state the name and address of recipient, and the total amount of payments.

Returns are required of "Information at the Source" of all payments of interest on bonds and mortgages or deeds of trust or similar obligations of corporations, regardless of amounts. This does not apply to obligations of the United States Government. **Interest on Bonds.**

Items of interest on bonds of foreign countries and dividends from stock of foreign corporations, not payable in the United States, collected by persons, partnerships or corporations as a matter of business are also required to be reported regardless of amounts.

Under the Act of 1913 it was provided that an alien who desired to establish himself as a permanent resident of the United States and thereby obtain the benefit of withholding on the basis of a "resident" could declare himself by filing a certificate with the withholding agent. **Aliens Permanent Residents.**

> Aliens coming to the United States with the intention of becoming residents thereof within the meaning and intent of the income tax statute, may establish that fact and have the privilege of resident aliens under the statute by filing with withholding agents a certificate in the following form (Form 1078) under oath, and which certificate shall be filed by said withholding agents with Collectors of Internal Revenue as justification for withholding on the basis of "residence" in the United States. (T. D. 2242.)

Under the amended law the income of nonresident aliens is subject to withholding. No doubt the privilege afforded aliens under the Act of 1913 will now be extended to them under the present law. In this connection it should be noted that such declaration by the alien subjects him to the War Income and the War Excess Profits Taxes upon his entire net income.

An alien, temporarily residing in the United States or employed therein for a definite time, who has the intention of leaving upon the termination of his employment or mission, is deemed not to be a resident of the United States for purposes of the income tax. **Temporary Residence in United States.**

> "Residence" has been defined to be:
> That place where a man has his true, fixed and per-

Residence Defined.

manent home and principal establishment, and to which, whenever he is absent, he has the intention of returning; and indicates permanency of occupation as distinct from lodging or boarding or temporary occupation.

For the purposes of the income tax,—it is held that where for business purposes or otherwise, an alien is permanently located in the United States; has there his principal business establishment and is there permanently occupied or employed, even though his domicile may be without the United States, he will be held to be within the definition of—

Every person residing in the United States, though not a citizen thereof. . . . (T. D. 2242.)

Visiting Alien.

An alien who resides in the United States temporarily, or who comes here only temporarily for employment, with the view of returning upon its completion, is a nonresident alien.

For the purposes of the Income Tax,—it is held that . . . aliens who are physically present in the United States, but only temporarily resident or employed therein (as for a reason or other similarly definite term, and with the expectation and intention of leaving the United States upon the termination of the employment or accomplishment of the purpose which necessitated presence in the United States,) are within the class of

"Persons residing elsewhere . . ." (T. D. 2242.)

Wife Assumes Nationality of Husband.

The income of an American woman who marries a foreigner is subject to the same laws as are applicable to her husband and if he is a nonresident alien the wife's income in the United States is subject to withholding.

An American woman who marries a foreigner takes the nationality of her husband. . . . (T. D. 2090.)

Withholding Tax Nonresident Alien Corporation Stock Dividend.

The Internal Revenue Bureau does not prescribe any particular method whereby the normal tax on stock dividends paid to nonresident alien corporations shall be withheld, leaving the adjustment thereof to be made between the debtor corporation and the recipient of the dividends.

"This office has before it your letter of March 17, 1917, relative to the withholding of normal tax upon a stock dividend paid by a domestic corporation to a nonresident alien corporation, joint-stock company, association or insurance company. In reply you are advised that while the Federal Income Tax Law of September 8, 1916 (Section 13-f), specifically provides that dividends paid to nonresident alien corporations, joint-stock companies, association or insurance companies having no office or place of business in the United States are subject to withholding of normal tax at the source, it does not prescribe a method to be followed in the withholding of that tax, and, therefore, the question as to how tax is to be withheld from a dividend paid in stock or scrip is one for adjustment between the debtor corporation and the recipient of the dividend. In view of the fact that the domestic corporation will be held liable for normal tax at the rate of two per cent. on any dividend paid on stock registered in the name of, and actually owned by, a foreign corporation, joint-stock company, etc., having no office or place of business in the United States, the office deems it proper to suggest that in the case of a dividend paid in stock or scrip, the debtor corporation may protect its own interests by requiring the foreign stockholder to deposit with it, prior to the payment of the dividend, an amount equal to the tax the former will be required to pay to the Federal Government; or the resolution providing for the dividend may be so drawn as to permit the debtor corporation, in the case of a dividend paid to a nonresident alien corporation shareholder, to deduct from the surplus from which the dividend is to be paid, and retain in its treasury, an amount sufficient to meet the withholding requirements and issue stock and scrip in payment of the balance due on the stock held by such a shareholder. In short, each corporation, so far as the law is concerned, must provide its own method for performing the duties required of it as a withholding agent in each case where that method is not specifically provided by the law." (Letter to Carter, Ledyard and Milburn, New York City, signed by Deputy Commissioner L. F. Speer, and dated April 10, 1917.)

CHAPTER III

INCOME TAX AS APPLIED TO PARTNERSHIPS

IX. General Partnerships

Partners Taxable Individually Only.

Persons conducting business in partnership are liable for income taxes and war income taxes only in their individual capacity. Under the Excess Profits Tax Law, however, partnerships are liable as separate entities the same as are corporations. (See page 120.)

Returns.

Partnerships are not required to make returns of net income unless especially ordered to do so by the Commissioner of Internal Revenue or any district collector. Where required, the returns shall be prepared on Form 1065, calling for the gross income, deductions and credits, and the names and addresses of the individuals who would be entitled to the net income, if distributed.

The individual members of the partnership are required to include in their returns their prorata share of the earnings of partnerships as shown by the books of account, whether such earnings were distributed or not.

Fiscal Year.

A partnership, when required to make a return, has the privilege of making the same for its own fiscal year the same as a corporation.

In case the fiscal year ends during a calendar year for which there is a rate of tax different from the rate for the preceding calendar year (for example, 1917 and 1916) the rate for the preceding calendar year will apply to an amount of each partner's share of such partnership profits equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year; the rate for the calendar year during which such fiscal year ends will apply to the remainder. For example:

If the fiscal year of a partnership ends on June 30, 1917, that proportion thereof (½) which falls within the year 1916 should be included as income of the individual partner in his

personal return for the year 1916; and the proportion that falls within the calendar year 1917 should be reported by the individual as a part of the earnings of the calendar year 1917 and be subject to the rates of taxes applicable to that calendar year. In other words, the income of a fiscal year should be so prorated between the calendar years that the partners' returns will reflect the income of the partnership for each calendar year and respectively be subject to the different rates of taxes.[1]

Dividends Received by Partnerships.

Partnership earnings must include dividends on the capital stock of corporations, joint-stock companies, or associations, or insurance companies owned by the partnership, except that in the case of nonresident aliens dividends received from sources without the United States should not be included.

Method of Accounting.

A partnership has the same privilege of making returns upon a basis other than that of receipts and disbursements as is accorded to corporations and individuals, so long as the method employed correctly reflects the income of the partnership. (See "Accrual Basis," page 197.)

Income When Accrued.

> "It is held that the income from a partnership accrues to the individual partner at the time his distributive interest is determined and reducible to possession. In the returns of income made by individuals for the calendar year, therefore, there should be included such income accruing from the business of partnerships for their business years as may have been definitely ascertained by means of a book balance, whether distributed or not. In other words, members of partnerships are required to make returns of income like other individuals for the calendar year, and should include in their returns the net proceeds of their interest in partnership profits ascertained at the end of the business year falling within the calendar year for which the individual return is being rendered." (T. D. 2090.)

[1] The Bureau of Internal Revenue has stated "If the partnership ends its fiscal year on some day during the calendar year (other than Dec. 31) your distributive share of its earnings or profits ascertained at that time should be reported." That is inadvisable because when an increase in rates of taxes occurs, the increase offsets earnings of a prior period. Partners so affected should file amended returns for the pro rata part of income earned by partnership to Dec. 31, 1916.

Premiums on policies of insurance on the lives of partners in favor of a partnership, commonly called "partnership insurance" are not deductible from income of either the partnership or individual partners. (See page 107.)

Premiums on Life Insurance Policies.

From the net distributive interests reported by the partners "there shall be excluded their proportionate shares received from interest on the obligations of a State or any political or taxing subdivision thereof, and upon the obligations of the United States (if and to the extent that it is provided in the Act authorizing the issue of such obligations of the United States that they are exempt from taxation) and its possession, and that, for the purpose of computing the normal tax there shall be allowed a credit . . . for their proportionate share of the profits derived from dividends." [Law, Section 8 (d).]

Credits on Individual Returns of Partners.

None of the expenses of a partnership shall be deducted from the return of net income of an individual.

Partnership Expenses.

X. Limited Partnership

In the administration of the income tax law it has been ruled that a limited partnership, with respect to its income, is subject to the provisions of law applicable to corporations; that is to say, a limited partnership must make its return on the blank provided for corporations (Form 1031, Revised), and must pay the normal tax as shown thereby.

Limited Partnership.

A limited partnership is one having one or more "special partners" whose liability is limited to the amount invested. It is created by complying with the State laws providing for that form of partnership. The usual requirements are that such partnership file certain certificates stating: the name of firm under which the limited partnership is to be conducted, its principal place of business, the general nature of the business intended to be transacted, the names of all general and special partners and their respective residences, the names of the special

partners and the amount of capital contributed by each of them, and the time that such partnership shall commence and terminate.

A limited partnership can only be created by complying with requirements of the statute of the State under which it is created.

Profits Limited Partnerships.

The profits of limited partnerships making returns in the same manner as corporations make returns will be treated the same as dividends of corporations and will be returned in the returns of individuals in the same manner as are dividends upon the stock of corporations; that is to say, the dividends received from such limited partnerships will not be subject to the normal tax in the hands of the members of the partnership receiving the same. (T. D. 2137.)

CHAPTER IV

TAXES APPLICABLE TO CORPORATIONS

XI. General Provisions

Income of Corporations Organized in United States.

The Federal income tax is levied, assessed, collected, and paid annually upon the total net income from all sources, received in the preceding calendar or fiscal year, by every corporation, joint-stock company or association, or insurance company, organized in the United States.

Income of Foreign Corporations.

The tax is paid annually by every corporation, joint-stock company or association, or insurance company organized under the laws of any foreign country, upon the total net income received from all sources within the United States in the preceding year, "including interest on bonds, notes or other interest-bearing obligations of residents, corporate or otherwise, and including the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations, or insurance companies whose net income is taxable under this title." [1]

Rates.

The tax of 2 per cent. under the Act of September 8, 1917, remains effective. In addition there is imposed a normal tax of 4 per cent. under the Act of October 3, 1917, designated the "War Income Tax," making a total tax of 6 per cent. upon the entire net income of corporations effective from January 1, 1917.

Dividends received by domestic corporations are not subject to the war income tax of 4 per cent. The tax of 2 per cent. however, under the Act of 1916 is still applicable to dividends.

The following extract from a summary of the War Revenue Bill contained in the Congressional Record of October 16, 1917, explains the reason for the greater normal taxes imposed on

[1] Income of foreign governments received in the United States is not taxable.

corporations (6 per cent.) as compared with those imposed upon individuals (4 per cent.):

> In addition to the flat 2 per cent. corporation tax imposed by the Act of September 8, 1916, this act (War Income Tax) imposes another tax of 4 per cent., making the total tax upon such corporations 6 per cent. This is higher than the flat 4 per cent. total normal tax upon individuals. The reason for this difference is that the individual pays surtaxes upon all his income in excess of $5,000, while the corporation is allowed to retain for use in the business any necessary amount of its net income, thus avoiding the payment of any surtaxes upon the amount so retained. This gives them the advantage over the individual of being able to use in their business as capital income that has not paid the income surtaxes, while the individual or partnership can not do so.

Specific Exemption.

There is no specific exemption to corporations either under the Income Tax Law of September 8, 1917, or the War Income Tax Law of October 3, 1917.

Foreign Income Taxable.

A domestic corporation is taxable upon its entire net income regardless of where such income was derived. A domestic corporation, for example, maintaining only a nominal office in the United States, and obtaining all of its profits from foreign countries, is, nevertheless, taxable upon its entire net income, the same as a citizen residing in a foreign country.

Excess Profits Tax.

The Excess Profits Tax, enacted as a part of the War Revenue Bill of October 3, 1917, imposes upon trades and businesses, occupations and professions a flat tax of 8 per cent., less an exemption, in cases where only a nominal or not more than a nominal capital is employed, and graduated rates of taxes, less a deduction for prewar profits and an exemption, in cases where actual capital is employed. (See Chapter V, pages 116 to 174.)

Undistributed Surplus Tax.

The undistributed surplus of corporations has not heretofore been subject to any additional or surtax as has been that of undivided profits of partnerships and individuals. As a result of this disparity corporations have been permitted to accumulate surpluses which have escaped the additional taxes to which that of other forms of

enterprise have been subjected. For the purpose of correcting this inequality and with the view of coercing corporations to distribute their earnings, there was incorporated in the amendments to the Act of September 8, 1916 (enacted October 3, 1917), a provision for a tax upon the undistributed profits of corporations. [Section 10 of Part II, paragraph (b).]

This tax will affect only the undistributed surplus earned after January 1, 1917. Under the Act of September 8, 1916, an unreasonably large surplus could be made subject to the additional tax applicable to individuals, where the Secretary of the Treasury certified that in his opinion the accumulated surplus was unreasonable for the purposes of the business. That section of the law (Section 3) states that gains or profits accumulated beyond the reasonable needs of the business will be *prima facie* evidence of a fraudulent purpose to escape the tax; in mitigation of this language, however, it declares that the mere existence of a large surplus will not in itself be evidence of a purpose to escape the tax unless the Secretary of the Treasury shall certify such to be his opinion. There appear to be no cases on record where this provision of existing law has been exercised, and, it is highly unlikely that it would be enforced except in a case of unconscionable evasion.

The undistributed surplus tax is only operative in respect of the net income of the corporation remaining undistributed six months after the close of the calendar or fiscal year, exclusive of the amount of any income taxes paid within the year. Furthermore, it exempts any part of such income that has been actually invested in or is employed in the business or retained for employment in the reasonable needs of the business, or is invested in obligations of the United States issued after September 1, 1917.

How far-reaching this tax will prove to be is a matter of conjecture. That it will be a revenue producer is problematical. The enforcement of the spirit of the law will be difficult. Regardless of the amount of earnings remaining undistributed at the end of six months after the fiscal or calendar year, if the corporation has no available funds (cash) out of which to pay dividends the earnings are actually invested and employed in the business, the corporation cannot consistently be ordered

to convert its property into cash with which to pay dividends. It is reasonable to assume, also, that an amount of cash on hand not in excess of its current obligations is "retained for employment" and is "reasonably required" in the business.[1]

The rate of tax is ten (10) per cent. upon the amount remaining undistributed six months after the end of the calendar or fiscal year of the net income of corporations earned during the year as appears by their income tax returns, after deducting income taxes paid within the year. In the event that the Department should find that any part of the amount retained out of surplus is not required for employment in the business or is not reasonably required therein, a tax of fifteen (15) per cent. would be imposed and collected.

The double tax upon dividends received by corporations, under the Act of September 8, 1916, is still effective. The War Revenue Bill proposed by the Senate (not accepted by the House) contained an amendment of the Act of 1916 correcting this defect, but, in the Bill drawn by the Joint Conference Committee of the Senate and the House, which ultimately passed, the amendment was omitted. By provision of the War Income Tax Law, enacted October 3, 1917, dividends received by corporations are not taxable thereon. Hence, in a consideration of the combined income and war income taxes, dividends received by corporations are subject to the normal tax of 2 per cent. and free from the war income tax of 4 per cent. **Dividends.**

It will follow, therefore, that the net income of corporations subject to the tax of 2 per cent. will be credited with the amount of dividends received from corporations taxed upon their net income in ascertaining the amount upon which the 4 per cent. tax will be assessed.

XII. Returns of Corporations

All corporations, domestic and foreign, are required to make returns on Form 1031, Revised, except insurance companies, whose returns are made on Form 1030, Revised. **Form of Return.**

[1] Earnings used for the purchase of preferred stock or bonds for cancellation are "retained for employment" in the business and not taxable as undistributed surplus.

Return of Domestic Corporation.

The return of a domestic corporation shall be made to the Collector of the district in which is located its principal office, or where its books of account and other data are kept, from which the return is prepared.

Return of Foreign Corporation.

In the case of a foreign corporation, the return should be filed with the collector of the district in which is located its principal place of business in the United States, or if it has no principal place of business, office or agency within the United States, then with the Collector of Internal Revenue at Baltimore, Maryland.

Due Date of Return.

All returns shall be filed with the Collector on or before the 1st day of March of each year unless the fiscal year of the corporation has been designated in the manner prescribed, in which case the return must be filed within sixty days after the close of such designated fiscal year.

When Last Filing Day Falls on Sunday or Legal Holiday.

When the due date of filing a return, March 1st, or where an extension has been obtained, the last day of such extended time, falls on Sunday or a legal holiday, the last due date will be the day next following such Sunday or legal holiday. In case the return is transmitted by mail it should be posted in ample time to reach the Collector's office "under ordinary handling of the mails, on or before the date on which the return is thus made due in the office of the Collector."

Execution of Returns.

"The return shall be sworn to by the President, Vice-president or other principal officer, and by the Treasurer or Assistant Treasurer."

When Tax Payable.

Corporations making returns on the basis of the calendar year will be notified of the amount of their assessments on or before the first day of June of each year and the amount of said assessment shall be paid on or before the fifteenth day of June.

Delayed Payment Penalty.

To any sum or sums due and unpaid after ten days' notice and demand thereof by the Collector, there shall be added interest at the rate of 1 per cent. per month upon said tax from the time the same became due, and a further penalty of 5 per cent. on the amount of the tax unpaid.

A corporation whose fiscal year is not the calendar year, may make its return on the basis of its fiscal year by complying with prescribed requirements. The designated fiscal year must end on the last day of some month. The corporation shall give notice to the Collector of the district in which its principal office is located, at any time not less than 30 days prior to March 1st of the year in which its return would be filed if made upon the basis of the calendar year. Although not required under the law, it is advisable to obtain the consent of the Collector before proceeding to file returns for any period other than the calendar year.

Returns for Fiscal Year of Corporation.

Designating Fiscal Year.

Illustration: The fiscal year of a corporation ends on June 30th. It has made its returns, say, for the year 1916 based on the calendar year (January 1st to December 31st, 1916). In order (December 1st, 1917) to obtain permission to make its return on the basis of its fiscal year (June 30th) it must serve notice on the Collector not later than 30 days prior to March 1st, 1918 (on or before January 29th, 1918). Its return for six months ended June 30th, 1917, must be filed on or before March 1st, 1918, and the return for year ending June 30th, 1918, must be filed within sixty days thereafter (on or before August 29th, 1918). From that time on its annual returns will be made for each year ending June 30th, which return must be filed within 60 days, i. e., on or before August 29th.

A corporation that has designated its own fiscal year shall pay a tax on the proportion of the total net income returned for the fiscal year ending prior to December 31, 1917, which the period between January 1, 1917, and the end of such fiscal year bears to the whole of such fiscal year; that is to say, a corporation, the fiscal year of which ends on November 30, 1917, shall pay a tax (under the old law) on 1/12 of its net income of said fiscal year (for the month of December, 1916) and on 11/12 of said income (for period from January 1 to November 30, 1917), under the new and old laws.

Apportioning Income for 1917.

The tax under the designated fiscal year becomes due and

payable 105 days after the last due date upon which it is required to file the return, which, in the illustration cited, would be December 12th of the same year that the return is made.

Fiscal Year When Tax Payable.

Section 3176 of the revised statute provides that: "If the failure to file a return or list is due to sickness or absence, the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper." Application for such extension should be made to the Collector on or before the first day of March.

Extension of Time to File Return.

Section 14 (c) provides, further, "That the Commissioner of Internal Revenue shall have authority, in the case of either corporations or individuals, to grant a reasonable extension of time in meritorious cases, as he may deem proper."

In case of failure to file a return within the time prescribed by law or by the Collector, the Commissioner of Internal Revenue shall add 50 per cent. of the amount of the tax. When a return is voluntarily, and without notice from the Collector, filed after the due time, and it is shown that the failure to file the return was due to a reasonable cause and not to wilful neglect, no such addition shall be made to the tax.

Failure to File Return Penalty.

In case a false or fraudulent return is wilfully made, the Commissioner of Internal Revenue shall add to the tax 100 per cent. of its amount. Section 3176 of the revised statutes further provides that "The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

False or Fraudulent Return Penalty.

Section 18 of the Income Tax Law further states that "Any individual or any officer of any corporation, joint-stock company or association or insurance company required by law to make, render, sign or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this title to be made shall be guilty of a misdemeanor, and shall be fined not exceeding

$2,000 or be imprisoned not exceeding one year, or both, in the discretion of the court, with the costs of prosecution."

Section 14 (c) contains the provision that "If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding $10,000." **Refusal or Neglect to Make Return Penalty.**

In cases of refusal or neglect to make return, and in cases of erroneous, false or fraudulent returns, the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after such return is due, make a return upon information obtained as provided for by existing law. The assessment, based upon a return so made, shall become due and payable immediately upon notification of the amount thereof. **Return by Commissioner of Internal Revenue.**

> "When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, no tax collected under such assessment shall be recovered by any suit unless it is proved that the said list, statement, or return was not false nor fraudulent and did not contain any understatement or undervaluation; but this section shall not apply to statements or returns made or to be made in good faith under the laws of the United States regarding annual depreciation of oil or gas wells and mines." (Section 3225, Revised Statutes.) **Second Assessment.** **Recovery of Amount Paid.**

The contents of returns of net income constitute a public record, open to inspection "only upon the order of the President under rules and regulations prescribed by the Secretary of the Treasury and approved by the President." **Publicity of Returns.**

A corporation which has not been completely organized,

that is to say, has not accepted the charter granted to it, and has transacted no business should report such facts to the Collector and will then be relieved of the necessity of making a return as a corporation until its organization has been completed. (T. D. 2152.)

Corporations Incompletely Organized.

All Existing Corporations Must Make Returns.

The fact that a corporation has received no income is no excuse for failure to make return. The duty to make a return depends upon corporate existence and not upon receipt of income.

Returns of Corporations Maintaining Foreign Branches.

In the event that it should not be possible for a corporation to obtain from its foreign branches the necessary data from which to make a complete and accurate report, it is advisable to prepare and file a tentative return showing, in so far as obtainable, the income from all operations of such company, to which should be attached a memorandum to the effect that, by reason of inability to obtain the necessary information in due time the income reported does not include income from all sources. Such report should be marked "Tentative Return." When the necessary data is received an amended return, so marked, should be filed, and the assessment will then be fixed thereon.

Collectors of Internal Revenue are permitted to accept tentative returns in cases other than that mentioned above (foreign branches) where true returns cannot be rendered in due time or within the extended time as provided by law. The practice, however, should only be resorted to when it is unavoidable.

Returns of Holding Companies.

"In a case wherein a holding company actually takes up each month on its books its proportionate share of the earnings of the underlying companies, such holding company will be required to include in its gross income the amounts thus taken up regardless of the fact that the same may not have been actually paid to it in cash. The fact that the underlying companies credit to the holding company the amount of earnings to which it is entitled on the basis of the stock it holds, together with the fact that the holding company takes up on its books the amount thus credited, renders it incumbent upon the holding company to return these amounts as income, regardless of the fact that the underlying companies needed

these earnings and used them in making extensions and improvements and in furtherance of their business. Expenditures for such extensions and improvements being chargeable to the property account of the subsidiary companies are not deductible from the gross income and will therefore not have the effect to reduce the earnings to their respective shares of which the stockholders are entitled." (Supplement to Black on Income Taxes.)

Returns of Subsidiary Companies.

The existence of a corporation is sufficient to compel the rendering of a return of net income. The fact that a subsidiary company has had no income and no expenses does not excuse it from making a return. In case there has been neither income nor expenses, the return should specifically state such facts.

It is quite usual for a subsidiary company to keep its books and maintain its principal office at a place other than where its operations are conducted. In such case, as where the subsidiary company's office is maintained in the place where the holding company has its office, the return should be made in the district of the place where its books of account are kept.

It is customary for subsidiary companies to transmit to the parent company all of its earnings after deducting its expenses. Such income received by the parent company is construed to be dividends by the subsidiary company, subject to tax in the return of the parent company, as well as in the return of the subsidiary.

Receivers, Trustees, Assignees.

Receivers and trustees in bankruptcy, and assignees, who are operating the property or business of corporations that are subject to the income tax must make returns of net income for such corporations. Corporations in the hands of receivers, trustees or conservators are subject to the income tax and must make returns.

Corporations Organized During Tax Year.

A corporation organized during the tax year should make a return as at the end of the calendar year unless a fiscal year other than the calendar year has been designated. (Art. 84, Reg. 33.) (See "Returns for Fiscal Year of Corporation," page 77.)

A corporation that has done no business since its organization, must, nevertheless, make a return as at the end of the calendar year unless it has complied with requirements of law as to designating a fiscal year other than the calendar year. (T. D. 2090.)

Return of Corporation in Liquidation.

The following is a reply to an inquiry of the Corporation Trust Co., on the question of responsibility for payment of income taxes due under a final return by a liquidating corporation:

"In reply you are informed, that under the regulations of this office, at the time a corporation dissolves or liquidates, it is required to make what is termed a final return, and if such return shows a net income for that portion of the year during which the corporation was in business, the proper officers of the corporation should retain sufficient funds out of which to pay the income tax assessable on the basis of the income so returned. If the funds for this purpose are not retained, this office will look primarily to the officers of the corporation for the payment of the tax shown to be due, and should they fail to pay the tax, the Government will look to the stockholders for its payment." Dated March 22, 1917; signed by Acting Commissioner David A. Gates.

Liability of Dissolved Corporation after Dissolution.

It has been ruled that a corporation, dissolved in the year 1917, prior to the enactment of the War Revenue Bill (October 3, 1917), is liable for taxes thereunder.

"This office has had reason to review the decision contained in that letter and now holds, in accordance with the decision of the United States Circuit Court of Appeals in the case of Nicholas F. Brady, et al., executors, *v.* Charles W. Anderson, Collector, reported in Volume 240, Fed. Rep., p. 665, that a corporation which was dissolved during the year 1917 prior to the approval of the Act of October 3, 1917, is subject to the taxes imposed by that Act. In the case cited, suit was brought by the executors against the Collector of Internal Revenue to recover taxes assessed and paid by the executors under protest upon

income received by Nicholas F. Brady during his lifetime before the income tax act of October 3, 1913, was passed. Mr. Brady died July 22, 1913; and his executors, in accordance with the requirements of law made a return of income received by him between March 1, the effective date of the Act and July 22, 1913, the date of his death. It was contended by the representative of the taxpayer that income which had been received by the taxpayer who died prior to the passage of the Act was not subject to tax under its provision, but the Court held that: 'The effect of making the Act retroactive is, in our opinion, to apply it to Brady exactly as if it had been enacted March 1, 1913.' Applying this holding of the Court to the case of a domestic corporation which was dissolved prior to the enactment of the Act of October 3, 1917, the conclusion is reached that such corporation is subject to the tax imposed by the Act of October 3, 1917, and therefore in accordance with the provisions of such Act, for the reason that it is retroactive and in force and effect as of and from the first day of January, 1917, and applies to any and all corporations making returns or having a taxable income during the taxable period of 1917, it should file a return in accordance with the provisions of the Act of October 3, 1917, and pay the taxes imposed by such Act." (Extract from Letter to Joseph and Alvin T. Sapinsky, New York, N. Y., signed by Commissioner Daniel C. Roper, and dated November 17, 1917.)

Returns Interstate Commerce Corporations.

It has been held that corporations required to keep their books according to a uniform system of accounting prescribed by the Interstate Commerce Commission, may supply the information called for by Form 1031 "by classes rather than giving the items in detail, classifying the income and expenditures in the same manner as is required as to these items by the Interstate Commerce Commission."

"In reply to your request that the railway companies which you represent be permitted to file a schedule of the deductions allowed under the law in conformity with the Uniform System of Accounts ordered by the Public Service Commission, instead of the division indicated by the return,

you are informed that the division indicated in the supplementary statement forming a part of the return is merely suggestive. This office desires information, as far as possible, in detail, as to what items go to make up the general expenses.

"If this information is sufficiently given in detail in the schedule of deductions allowed under the law in conformity with the Uniform System of Accounts ordered by the Public Service Commission, this office has no objection to such a statement being attached to the return.

"It should be understood, however, that this permission does not carry with it a ruling that all of the items included in such schedule will be held to be allowable deductions from gross income for the purposes of the income tax." (A letter to James L. Quackenbush, of New York, signed by Commissioner W. H. Osborn, and dated January 6, 1915.)

Foreign Corporations Represented by Agents.

Foreign corporations represented in the United States by agents, or those maintaining branch offices therein, must make returns of total net income received from all sources within the United States. (T. D. 2137.)

It has been held that a foreign corporation represented by an agent in the United States for the solicitation of orders who has only a mailing address and where the merchandise sold is shipped direct to the customer, such representation constitutes doing business in this country and subjects the foreign corporation to an income tax. (T. D. 2161.)

Foreign Corporation having Branches in U. S.

A foreign corporation having several branch offices in the United States should designate one of such branches as its principal office and should also designate the proper officers to make the required return. (Art. 83, Reg. 33.)

XIII. Exempt Organizations

The following classes of corporations and organizations are exempt from requirements of the income tax law except the withholding of tax at the source, in cases where it is required.

under the Act of October 3, 1917, and reporting and paying the same to the Government.

First—Labor, agricultural or horticultural organization;

Second—Mutual savings bank not having a capital stock represented by shares;

Third—Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

Fourth—Domestic building and loan association and coöperative banks without capital stock organized and operated for mutual purposes and without profit;

Fifth—Cemetery company owned and operated exclusively for the benefit of its members;

Sixth—Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

Seventh—Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

Eighth—Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

Ninth—Club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

Tenth—Farmers, or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or coöperative telephone company; or like organization of a purely local character; the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

Eleventh—Farmers', fruit growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth—Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth—Federal land banks and national farm-loan associations as provided in section twenty-six of the Act approved July seventeenth, nineteen hundred and sixteen, entitled "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farms loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Fourteenth—Joint-stock land banks as to income derived from bonds or debentures of other joint-stock land banks or any Federal land bank belonging to such joint-stock land bank.

Under the language of the Income Tax Law of 1913, it was held that exempt corporations and organizations were exempt from all provisions of the law. Under the law, enacted September 8, 1916, it was ruled by the Commissioner of Internal Revenue that the fourteen different kinds of exempt corporations and organizations named in the law are relieved only of the tax on their income, and "that said corporations and organizations are required to answer under all the other provisions of the statute as to withholding and making returns of tax withheld." Under the Act of October 3, 1917, this ruling will only be applicable to income payable to nonresident alien individuals, foreign corporations and partnerships, and in respect of interest on corporate obligations containing a tax-free covenant clause.

Exempt Corporations Required to Withhold Tax.

In all cases where there is a question of doubt as to whether an organization is or is not exempt, it is recommended that a special ruling be obtained from the Commissioner of Internal Revenue. The application for such ruling should be accompanied by an affidavit stating: **Organizations Doubtful as to Exemption.**

(a) The purpose and nature of the organization
(b) The source of its income
(c) The disposition of its income
(d) Whether or not any of its net income will inure to the benefit of any private stockholder or individual.

It has been ruled that foreign as well as domestic corporations and organizations, of the classes enumerated in the exempt list, are included therein. **Exempt Foreign Organizations.**

> "Receipt is acknowledged of your letter of November 17, 1916, and in reply you are advised that the Federal Income Tax Law of September 8, 1916, provides that every organization enumerated in Section II of that statute is exempt from Federal Income Tax on its net earnings, profits or income, and the office holds that the provisions apply whether the organization be domestic or foreign. In a case where a foreign organization desires to be held exempt from Federal Income Tax, and a doubt exists as to whether or not it comes within the class of organizations enumerated in Section II, it will be required to file a copy of its charter and by-laws, and an affidavit executed by its principal officer showing the disposition made of such income as it receives, and stating specifically, whether or not any of the income so received inures to the benefit of any individual stockholder. The question of whether or not the office will hold the organization to be 'exempt' will be determined by the facts shown in its charter, by-laws and affidavit." (Letter to the Corporation Trust Company, signed by Commissioner W. H. Osborn, and dated December 6, 1916.)

A so-called "close corporation," which usually consists of members of a family, is not such corporation as is exempt from the requirements of the income tax law. **Close Corporation.**

A corporation formed as a family affair to hold property together and not to sacrifice in selling does not come within the class of corporations specifically enumerated as exempt from the requirements of the Federal Income Tax Law, and is required to make a return of annual net income showing therein all income arising and accruing to it from all sources and to pay any income tax shown by such return to be due. (T. D. 2137.)

Corporations not Organized for Profit.

The fact that a corporation or association was not organized for profit is immaterial in determining whether or not such corporation or association must make returns of net income. All corporations, joint-stock companies or associations and insurance companies, unless specifically mentioned in the law as exempt, must make returns.

The tax imposed by the Federal income tax law is not imposed only upon such corporations as are organized and operated for profit. Any corporation, joint-stock company, or association, and any insurance company, no matter how created or organized or what the purposes of its organization may be, unless it comes within the class of organizations specifically enumerated in the act as exempt, will be required to make returns of annual net income and pay income tax upon the net income which arises and accrues to it during the year.

A corporation is not exempt simply and only because it is primarily not organized and operated for profit. If income within the meaning of the law arises and accrues to a corporation which is not organized and operated for profit, such income will be subject to the tax imposed by this act.

It is therefore held that commercial men's associations, . . . and like organizations come within the requirements of the law. (T. D. 2152.)

Corporations Controlled by Exempt Organizations.

The fact that all the stock of a nonexempt corporation is owned and controlled by an association, exempt under the law, does not relieve such corporation of making returns. The liability of a corporation to report and pay the income tax is not contingent upon the ownership of its stock but upon the character of the organization, which latter alone determines whether or not it is exempt.

A stock corporation all of whose stock is owned by a "corporation or association organized and operated exclusively for religious, charitable, scientific or educational purposes, no part of whose net income inures to the benefit of any member, stockholder, or individual," is required under the provisions of the Federal Income Tax Law to make a return of annual net income and pay income tax.

The fact that all of the stock of the corporation, except shares qualifying the directors, is owned by a corporation which itself comes within the class specifically enumerated as exempt, does not relieve the first-named corporation from liability under the Income Tax Law. The liability of a corporation to the requirements of the Federal income tax law is not contingent upon the ownership of its stock. (T. D. 2137.)

Treasury Department rulings indicate that organizations operated for profit, regardless of the character of their pursuits, are subject to the income tax and must make returns. Specific rulings to this effect have been made with respect to agricultural and horticultural organizations (T. D. 2090) and coöperative dairies. (T. D. 1996.) **Organization Operated for Profit.**

In Union Hollywood Water Co. *v.* John P. Coster, Collector (238 Fed. 329), it was held that: **Water Company not Exempt.**

The fact that plaintiff was a public utilities corporation which, under the laws of the State, was not the owner of the property but merely intrusted with the use thereof which it must devote to the public, does not entitle it to more favorable treatment than other corporations, it being a corporation organized for profit, having a capital stock represented by shares, and the Act making no exceptions in favor of public utilities.

XIV. Income of Corporations

The term "net income" as used in the income tax law with respect to corporations, may be defined as the "gross income" less deductions allowed by law. **Net Income.**

Gross income of manufacturing companies shall con-

sist of the total sales of manufactured goods during the year covered by the return, increased or decreased by the gain or loss as shown by the inventories of finished and unfinished products, raw material, etc., at the beginning and end of the year. To this amount should be added the income, gains, or profits from all other sources as shown by the books of account. (Art. 104, Reg. 33.) (See Manufacturing Corporation Operating Cost-system, page 216.)

Gross Income Manufacturing Corporations.

Gross income of mercantile companies shall include the total merchandise sales during the year, increased or decreased by the gain or loss as shown by the inventories of merchandise at the beginning and end of the year for which the return is made; to this amount should be added the income, gains, or profits derived from all other sources as shown by the books of account. (Art. 105, Reg. 33.)

Gross Income Mercantile Corporations.

Gross income of miscellaneous corporations consists of the total revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income, including the income, gains, or profits from all other sources, as shown by the books of account. (Art. 106, Reg. 33.)

Gross Income Miscellaneous Corporations.

In the case of a large contracting company, which has numerous uncompleted contracts which probably, in some cases, run for periods of several years, there does not appear to be any objection to such corporation preparing its return in such manner that its gross income will be arrived at on the basis of completed work—that is to say, on jobs which have been finally completed and payments made during the year in which the return is made. If the gross income is arrived at in this method, the deductions from gross income should be limited to the expenditures made on account of such completed contracts. (T. D. 2161.)

Gross Income Contracting Corporations.

It will be noted from these definitions that the gross income embraces not only the operating revenues, but also income, gains, or profits from all other sources, such as rentals, royalties, interest, and dividends from stock owned in other corporations . . ., also profits made from the sale of assets, investments, etc. (Art. 107, Reg. 33.)

Gross Income From All Sources.

Gross income of insurance companies consists of the total revenue derived from the operation of the business, including income, gains, or profits from all other sources, as shown by the entries on the books of account within the calendar or fiscal year for which the return is made, except as modified by the express exemptions of the articles which apply to mutual fire, mutual marine, and life insurance companies. (Art. 97, Reg. 33.)

Gross Income Insurance Companies.

Gross income of banks and other financial institutions consists of the total revenue derived from the operation of the business, including income, gains, or profits from all other sources, as shown by the entries on the books of account, within the calendar or fiscal year for which the return is made. (Art. 96, Reg. 33.)

Gross Income of Banks.

Mutual associations or companies, such as, fire, employers' liability, workmen's compensation, casualty insurance companies, that require their members to make premium deposits to provide for losses and expenses, are not required to return as income any portion of the premium deposits returned to policyholders. Income from all other sources, however, including that received from its members as premium deposits, retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves, is returnable as income.

Mutual Companies.

Dividends may be declared payable in cash or the equivalent of cash. Where dividends are declared payable in securities of another corporation or of a foreign government, the value placed upon such securities should be the fair cash market value thereof as at the time the dividend is declared.

Dividends Payable in Securities.

Profit or income from the sale of capital assets is subject to the income tax and must be included in the return of corporations.

Profit on Sales of Capital Assets.

For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal or mixed, acquired before March 1, 1913, the fair market price or value of such property as of March 1, 1913, shall be the basis for determining the amount of such gain derived.

Sales of Property Acquired Prior to March 1st, 1913.

For method of computing profit or loss on properties acquired prior to March 1, 1913, see page 34.

Interest on Sinking Funds. Interest received on sinking funds or from any investment of reserve funds, shall be accounted for as income.

In cases wherein corporations set aside and place in a sinking fund under the control of trustees their own bonds or the bonds of other corporations which they may own, it is held that the fund thus set aside by the corporation is an asset of the corporation, and any increment to that fund as a result of investments made by the trustees having the same in charge is income to the corporation and should be so included and accounted for in its returns of annual net income.

If the trustees have invested the amount of the sinking fund reserve or any portion of it in the bonds of the corporation and such corporation pays to the trustees the interest on these bonds, such corporation will be permitted to deduct such interest from its gross income, provided the amount of the interest thus paid, plus the interest on any other outstanding indebtedness which it may have, does not exceed the limit fixed by the law, and provided further that the interest paid to the trustees, together with all other earnings on investments of the sinking fund made by the trustees, is included in the income of the corporation. (T. D. 2161.)

Assessment of Paid-up Capital Stock Not Income. Where a corporation sustains a deficit (impairment of capital) at the close of a year, which the stockholders propose to make good by voluntary contribution, such contribution or assessment is not income to the corporation. In a letter to Dorman & Dana, New York, dated February 21, 1916, Commissioner W. H. Osborn expressed himself as follows:

"It is therefore the present opinion of this office that the amounts paid by the stockholders pursuant to this so-called voluntary assessment, are to all intents and purposes, if not in fact, additional payments for the stock which they hold, that is to say, such payments are simply an addition to the capital stock of the company. Since amounts paid for or on account of capital stock issued do not constitute income

within the meaning of the Federal income tax law, it is held that these payments represent voluntary assessments upon the stock held by the individual stockholders and do not constitute income to be returned for the purpose of the income tax."

Exchange of Stocks and Bonds in Reorganization. Closed Transaction Defined.

According to the following ruling by the Department in the case of an exchange of stocks and bonds for an interest in property, the value of the securities received in excess of the cost of the property relinquished, constitutes taxable income.

"Replying to your letter of the 28th ultimo, you are informed—(1) That in a case wherein an investment company purchases one-third interest in a telephone company paying therefor $40,000, the telephone company being reorganized, and as a result of the reorganization the investment company surrenders whatever certificates of ownership it has in the old company and receives in return $40,000 par value of bonds and $40,000 par value of stock of the reorganized company, the bonds having a ready market value of par and the stock at 50% of par, it will be held that this constitutes a closed and complete transaction in that the old stock has been disposed of for a readily determinable value, namely, $40,000 actual value of bonds, and $20,000 actual value of stock. Hence the investment company at this point has realized on its original investment a profit of $20,000 which will be returned as income of the year in which the transaction was closed. (2) After the foregoing transaction, if the investment company sells the bonds for $40,000 and retains the stock which is reasonably worth $20,000, it will be held that so far as this particular transaction is concerned, no income has been realized and none will be realized until the stock retained has been sold or disposed of for a price or value greater than the $20,000 returnable as income under the first transaction. (3) If the $20,000 of stock is traded for bonds in another corporation worth $20,000, no taxable income will result from this transaction as it is held to be an exchange of assets of a different form but of equal value. (4) In the sale or disposition of capital assets, a closed and completed transaction is held to be one in which an asset is disposed of

for cash or for assets other than cash, at a fixed or determined value, that is, for cash or its equivalent in value at the time the transaction is consummated. If the assets are exchanged for other assets of a like character, and no account is taken of compensatory value, it will be held that such a transaction constitutes merely a change in the form of assets, and the investment will be considered a continuing one, no profit or loss to be taken into account until the assets are disposed of for cash or its equivalent on the basis thereinbefore indicated." (Letter to F. B. MacKinnon, Washington, D. C., signed by Acting Commissioner David A. Gates and dated August 3, 1917.)

Premium Sale of Capital Stock.

The amount received by a corporation for the original issue and sale of its capital stock is held to be the capital of the corporation. In cases where the stock, as originally issued, is sold at a price greater or less than the par value, neither the premium nor the discount will be taken into account in determining the net income of the corporation for the year in which the stock is sold. This is purely a capital transaction and the income is neither increased nor decreased by reason of the sale, *per se*, of the stock at a price greater or less than its par value. (T. D. 2090.)

Income of Real Estate Development Corporation.

A real estate development corporation, ordinarily, does not realize a profit until the property or properties of such company have been developed. During the time of such development certain carrying charges are incurred, as interest, taxes, insurance, etc. Inasmuch as it would work an injustice to compel such company to deduct carrying charges as current expenses during the period of development, when the property derives no profit, it has been ruled that all such carrying charges may be added to the cost of the property. During the time of development the income from the sale of lots, or parcels, may be deducted from the total cost of land, including the initial cost plus carrying charges and the corporation will return no profit until the amount of sales, or contracts of sales, exceed the prime cost of property plus carrying charges.

In the case of a contract of sale of land on the instalment plan of payments by a development company, the gross amount

to be paid by the instalment purchaser is deemed income and is returnable, for income tax purposes in the year that the contract of sale is made. Should the purchaser default in payment, the amount of such default may be deducted as a loss sustained by reason thereof.[1]

> The cost of property acquired subsequent to the incidence of the tax will be the actual price paid for it, together with the expense incident to the procurement of the property in the first instance and its sale thereafter, and the cost of improvements or developments, if any. (T. D. 2005.)
>
> T. D. 2005 is not intended to be so construed that carrying charges, if they consist of such expenditures as constitute allowable deductions from gross income, are to be added to the cost of the property if there is a gross income from which such charges as constitute allowable deductions may be deducted. It is intended, however, that in the case of a holding or developing company, which has not yet reached the stage of having any income of consequence resulting from its corporate operations, the carrying charges or other excess over the incidental income received may be added to and made a part of the cost of the property. (T. D. 2137.)

Regardless of the form or manner of payment, such payment, received in a sale of real estate, is subject to income tax at the time the sale and transfer are made; that is to say, the vendor corporation accepting in payment, promissory notes, mortgages or a contract providing for instalment payments, must report the profit on the transaction in the returns for the year in which the transaction was consummated. Default in payment is deductible in the return for the year that the default occurs.

> For income tax purposes, where there is an actual sale and transfer, profit will be considered as realized even though payment is to be made in instalments, as notes for deferred payments are secured by the title to the property, and presumably bear interest and are held to be worth, in cash, their face value. (T. D. 2090.)

[1] Where the improvements have been paid for, and the cost per lot is determinable, the pro rata part of profit on instalments received may be returned for each year, less the necessary expenses. For example, a lot plus improvements cost $250; instalment contract of sale is for $500; collections received in the year, $100; then the profit is 50%, and $50, less necessary expenses, is the returnable net income.

In determining the amount of income to be accounted for on this basis the corporation will consider mortgages, mortgage notes, or any other credits received in payment of the property as though they were cash, and if it should occur that the purchaser of any of the property should later default in payment the corporation will be entitled to take credit as a loss for the amount of loss actually sustained by reason of the default. (T. D. 2137.)

In case of default on instalment payments there may be charged off as bad debts the amount of such unpaid installments less the salvage value of the real estate repossessed. (T. D. 2090.)

When Cost of Property Includes Carrying Charges, etc.

A very complete discussion of the question of cost of real estate, dealing with carrying charges, assessments for local benefits, etc., is contained in a letter to the Corporation Trust Co., signed by Commissioner W. H. Osborn, dated December 22, 1914, as follows:

"This office is in receipt of your letter of the 19th instant, in which, referring to Treasury Decision No. 2005 [cost of property purchased prior to the incidence of the special excise tax (January 1, 1909), or the incidence of the income tax (March 1, 1913), will be the actual price paid for the property, including the expense incident to the procurement of the property in the first instance and its sale thereafter, together with carrying charges of interest, insurance and taxes actually paid prior to the incidence of tax (special assessments, if any 'actually paid' as 'local benefits' in connection with real estate); provided that where, up to the incidence of the tax the expenses of carrying property has exceeded the income from it, the difference between the expense of carrying and the income from the property shall be added to the purchase price and the sum thus ascertained shall be the cost of the property; and provided further, that in the case of property purchased prior to the incidence of the tax and sale thereof subject to the incidence of the tax, there shall be excluded from consideration in ascertaining cost any items of income, expense, interest and taxes previously taken into account in preparing a return of annual net income. (T. D. 2005.)"] You submit, for a ruling of this office, the following inquiries:

"1. Is the matter in parentheses, beginning in line 6 of the paragraph, intended to mean that 'special assessments, if any, actually paid as local benefits in connection with real estate' may be added to the original cost of the property if such assessments are paid prior to the incidence of the tax?"

"2. May the assessments be added to the original cost of the property if they are paid subsequent to the incidence of the tax?"

"3. Reading the paragraph referred to from line 1 to the semi-colon in line 8, it appears that all carrying charges may be deducted. This, of course, is modified by the proviso beginning in line 8 and ending in line 12, which provides that if the expense of carrying the property has exceeded the income, the difference between the expense and the income shall be added to the purchase price, and the sum thus ascertained shall be the cost of the property.

"In reply, you are informed that special assessments, if any, actually paid as local benefits in connection with real estate are held to be expenditures which add to the value of the property and should be capitalized, whether such expenditures were made prior to, or subsequent to, the incidence of the tax; that is to say, such expenditures, no matter when paid, become, in effect, a part of the cost of the property. This answers your first and second inquiry.

"Replying to your third inquiry, you are informed that all carrying charges in excess of the income which may have been received prior to the sale of the property may be included as a part of the cost of such property, and the cost thus determined will be excluded from the gross proceeds of the sale when the property is sold, and the excess of such cost will be returned as income.

"This ruling is based upon the presumption that the corporation is doing business, and, having income as a result of the business done must use such income to offset, in as far as it will do so, the expenses necessary to the operation and maintenance of the business.

"If the carrying charges are less than the income, such carrying charges, unless they be for improvements and betterments, will not be added to and made part of the cost of the property, but will be deducted from the gross income received, in which case it would appear that the

return of the corporation would show a net income subject to tax.

"The Treasury Decision referred to is not intended to be so construed that the carrying charges, if they consist of such expenditures as constitute allowable deductions from gross income, are to be added to the cost of the property, if there is a gross income from which such charges as constitute allowable deductions may be deducted. It is intended, however, that in the case of a holding or developing company which has not yet reached the stage of having any income of consequence resulting from its corporate operations, the excess of the carrying charges over the incidental income received may be added to and made a part of the cost of the property.

"As a general proposition, involving the acquirement and holding of property for further sale, which property was acquired prior to the incidence of the tax and from which property there is but a nominal income, insufficient to meet the carrying charges, it would be proper to add to the original cost of the property the carrying charges of interest, insurance and taxes actually paid, and from that amount deduct the incidental income which may have been received between the date of purchase and the date of the incidence of the tax. The result thus shown will be the cost of the property, or the amount to be excluded from the proceeds when sale is made."

Income Instalment Businesses Generally.

Corporations and individuals selling merchandise on the instalment plan, or on "lease contracts," [1] should make their returns of gross income on the basis of the gross amount of contracts of sales made during the year. In other words, the gross amount to be paid by the customer under a contract for the sale or "leasing" of merchandise is construed to be the amount on which the gross profit is computed for income tax purposes. Uncollectable accounts, less salvage value of goods returned, if any, may be charged at the end of the year as bad debts. This principle is

[1] Where returns are made only of cash receipts, the proportion of profit on each instalment received may be returned as income. For example a piano sold for $400, cost $300, the gross profit is 25%. If $100 was collected in the year, 25% of $100, less operating expenses, would be returnable. This method is not feasable in a large business.

applicable to all kinds of instalment businesses, making returns on the accrual basis.

The question of computing the profit or loss from the sale of timber is always a difficult one. As in the case of other properties acquired prior to March 1, 1913, the fair market price or value of the timber should be determined as of that date. At best, such values must be more or less estimated, except when a *bona fide* offer of purchase for cash or its equivalent had been received at or near March 1, 1913. **Profit or Loss Timber, Lumber, Stumpage.**

A letter dated March 3, 1917, signed by Deputy Commissioner L. F. Speer, published by the Corporation Trust Co., outlines with marked degree of clearness, considering the complexity of the subject, a method by which to compute the profit or loss on the sale of timber and lumber, as follows:

> "In compliance with your request of the 1st instant, you are advised that the following information is furnished you in regard to the preparation of your returns of annual net income under the provisions of the Act of September 8, 1916, as far as the calculation of the value of standing timber as of March 1, 1913, is concerned, and it also represents the regulations of this office in regard to allowances to be deducted from gross income for the value of stumpage: Corporations owning timber land and logging off the timber and manufacturing it into lumber, will, if the timber was acquired prior to March 1, 1913, be permitted to exclude from gross income either through a deduction from gross receipts or through a charge into the cost of manufacturing the timber into lumber, an amount equivalent to the fair market price or value of the standing timber as of March 1, 1913. In order to secure the benefit of this deduction such corporations must set up on their books as of March 1, 1913, the fair market price *en bloc*, of all the timber then owned by them, and then by dividing this *en bloc* value by the estimated number of feet (board measure) in the entire timber holdings, the per unit value or price as of March 1, 1913, will be ascertained, which per unit price or value will be the basis for measuring the amount which may be added to the cost of manufacture, or deducted from gross income, until the *en bloc* value of the entire holdings as of March 1, 1913, shall have been extinguished, after which no further

deduction on this account shall be allowed. The same rule will apply in the case of timber or timber lands purchased subsequent to March 1, 1913, the only difference being that actual cost, that is the gross purchase price, shall, in making the computation, be substituted for *en bloc* price or value as of that date. If the entire market price or value of both timber and lands, as of March 1, 1913, or the entire cost, if acquired subsequent to that date, is extinguished through a deduction from gross income for timber used, or through a per unit charge to cost of manufacturing lumber, then the entire amount realized from the logged-off lands or for other salvage, will be returned as income of the year in which such lands are sold or disposed of. If the timber or timber lands are sold *en bloc*, the gain or loss will be ascertained on the basis of the difference between the fair market price or cost and the selling price, accordingly as the property was acquired prior or subsequent to March 1, 1913. The fair market price or value of timber or timber lands, as of March 1, 1913, is the price at which the property in its then condition and with the circumstances then surrounding it, could have been sold, for cash or its equivalent. This value must not be speculative, but must be determined without taking into account any prospective profits that may result from the manufacture of the timber into lumber. It must be, as the law contemplates, a fair market value, and, once determined, must be set up on the books, and, as the measure of a stumpage deduction for income tax purposes must remain constant and cannot be increased. The value so set up as of March 1, 1913, will be subject to the approval of the Commissioner of Internal Revenue. You are also informed that this office is not prepared to express an opinion at the present time as to what stumpage value would constitute a fair value of short leaf North Carolina pine as of March 1, 1913, and in regard to your further request you are informed that the ruling contained in the above regulation will refer equally as well to the years 1913, 1914 and 1915, with the exception that the cost of the timber shall be the governing basis instead of its value as of March 1, 1913."

Deductions Allowed Corporations

"All the ordinary and necessary expenses paid within the

year in the maintenance and operation of its business and properties" are deductible from gross income of corporations.

Expenses.

All losses actually sustained and charged off within the year, not compensated for by insurance or otherwise, are deductible items.

Losses Deductible.

The deduction for losses must be losses actually sustained during the year and not compensated by insurance or otherwise. It must be based upon the difference between the cost value and salvage value of property or assets, including in the latter value such amount, if any, as has, in the current or previous years, been set aside and deducted from gross income by way of depreciation. (Art. 124, Reg. 33.)

Deductions for losses should be confined to losses actually sustained and charged off during the year, and not compensated by insurance or otherwise. (Art. 158, Reg. 33.)

Loss Deductible Only in Year Sustained.

Losses not compensated by insurance must be deducted from the return of net income for the year in which the loss was sustained. This ruling has been upheld by the courts and is strictly enforced.

Profit or Loss on Property Acquired Before March 1, 1913.

For the purpose of computing the profit or loss from the sale of property of a corporation, acquired prior to the incidence of the law, March 1, 1913, such properties shall be valued as of that time at the fair market price thereof. This applies to both real and personal property.

Depreciation Deductible.

A reasonable allowance for the exhaustion, wear and tear of physical properties of a corporation arising out of its use or employment in the business or trade is deductible in the year that such depreciation is sustained. The amount deducted must be actually charged off upon the books of the corporation. (See "Depreciation," page 175.)

Depletion of Oil and Gas Wells.

(This deduction is considered in Chapter VI, on Depreciation, page 181.)

Under the Act of September 8, 1916, the provision of the Income Tax Act of 1913, limiting the charge for depletion of

mines to "5 per cent. of the gross value at the mine of the output for the year" has been repealed, and there has been substituted the provision that a reasonable allowance for depletion thereof will be permitted, "not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made" under rules and regulations to be prescribed by the Secretary of the Treasury.

Depletion of Mines.

Inasmuch as the operating conditions of mines are so materially different, the rate of depletion should be computed on a basis that will provide for the particular requirements of each case.

Maintenance Defined.

In Grand Rapids & Indiana Railway Co. *v.* Doyle, Collector (United States District Court for the Western District of Michigan, Southern Division [1]) maintenance was defined as follows:

> "Maintenance means the unkeep or preserving of the condition of the property to be operated and does not mean additions to the equipment, additions to the property, or improvements of former condition of the road."

Renewals. Improvements.

As a general proposition the cost of renewals in like kind and quality may be charged off as expense. Where the renewal, however, is also an improvement, as, for example, replacing a wooden bridge with a steel bridge, wooden doors with steel doors, a motor of twenty horse-power by one of fifty horse-power, the excess cost would not be allowable as a deduction. (T. D. 2210.)

Bad Debts.

The income tax law does not provide specifically, with respect to corporations, for the deduction of bad debts or uncollectible accounts. The officers of the Treasury Department, however, having the administration of the law in charge, have ruled that the same may be deducted as losses. (See also page 213.)

Reserves for Bad Debts.

To provide for doubtful and anticipated bad debts, by establishing a reserve for that purpose, has always been considered good accounting practice, but such reserve is not deductible from an income tax return. Accounts receivable, to be deductible from income,

[1] T. D. 2210.

must actually have been ascertained to be worthless. Besides, an account, to be deductible, must be actually written off in the period for which it is deducted.

Reserve Insurance Companies.

Amounts added to reserve funds of insurance companies, as required by law, are deductible from a return of net income.

Contingent and Secret Reserves.

Reserves set aside for contingencies, or so-called "secret reserves" are not deductible from returns of annual net income. Charging capital expenditures to operating expenses is specifically prohibited.

Suspense Items.

Items held in suspense, pending an event, are not deductible from income for income tax purposes.

Sinking Fund Reserves.

Amounts set aside out of profits, or reinvested, for the purpose of redeeming outstanding bonds payable, are not deductible from taxable income. The redemption of bonds is a capital expenditure.

Reserve for Discounts on Sales.

Discounts on sales of commodities dealt in are only deductible to the amount actually allowed to customers. A reserve for cash discounts, the establishment of which is approved by modern accounting, being anticipatory and not actual, is not deductible from income.

Interest Deductible.

A corporation is allowed as a deduction interest paid within the year on such an amount of indebtedness as does not exceed the sum of:

(a) The entire amount of the paid-up capital stock outstanding at the close of the year, or if no capital stock, the entire amount of capital employed in the business at the close of the year, and

(b) One-half of its interest-bearing indebtedness then outstanding.

This subject is more fully dealt with on page 202.

Interest Incurred in Purchase of Liberty 4's.

Under the Income Tax Law, as amended by the War Revenue Act, interest paid within the year on indebtedness incurred for the purchase of Liberty 4 per cent. bonds may be deducted in computing net income subject to income surtaxes and excess-profits taxes. In case of corporations this is subject to the limitations imposed by the income tax law on the amount of indebtedness, interest on which may be deducted. (T. D. 2541.)

Interest on Indebtedness Secured by Collateral, etc.

The interest paid during the year on indebtedness wholly secured by collateral, the subject of sale in the ordinary business of a corporation, joint-stock company or association, is deductible as an expense of doing business. Collateral, which may be the subject of sale in the ordinary business of a company, refers to commodities in which the company deals. Real estate, in this sense, could only be the subject of sale in the case of a corporation engaged in the buying and selling of real estate. This applies to both tangible and intangible property secured by collateral, but limits the amount of indebtedness on which the interest may be computed to the actual value of such property collateral.

In the case of Anderson *v.* Forty-two Broadway Co. (209 Fed. 991 and 213 Fed. 777, reversed by U. S. Sup. Ct., Oct., 1915) (T. D. 2261), it was held under the Corporation Excise Tax, that a real estate company owning and operating an office building, under mortgage, could not deduct the interest paid on such mortgage as a general expense, under item 4 (a) (Form 1031) but only in item 6 (a), which made it subject to the limitation of law as to deductibility of interest. For limitation of deductible interest under present law see page 204.

Interest on Preferred Stock.

Interest on any form or class of capital stock is not deductible from an income tax return. The fact that preferred stock is "guaranteed" or cumulative as to interest, does not make it deductible.

Interest on Bonds of Corporation.

Interest paid on outstanding bonds payable of a corporation is a deductible item. Where bonds are held by trustees, however, for the benefit of the issuing corporation, interest paid thereon is not deductible.

Amortization of Discount on Bonds.

In the case of a corporation selling its own bonds at a discount, the amount of the discount should be prorated over the life of the bonds and the proportionate part of such discount applicable to each year during the life of the bonds, constitutes an allowable deduction from the gross income of such year. The deduction from gross income in the case of twenty year bonds, would be one-twentieth of the aggregate amount of the discount on the bonds sold. (T. D. 2137.)

Where, however, bonds were sold at a discount prior to the incidence of the income tax law, and such discount had been charged off on the books of the corporation, then such discount or any part thereof, shall not again be deducted from the gross income.

Premium on Bonds Purchased.

In cases where bonds are purchased at a premium, such premium may be prorated over the remaining life of the bonds, so that only the redemption value thereof appears upon the books when the bonds mature.

Loss in Retirement of Bonds.

The general principles as to the deductibility of premium paid in the retirement of corporate bonds are as follows:

In the case of bonds sold by the corporation at par and redeemed at a premium, the premium paid is deductible as a loss (1).

If the bonds were sold by the corporation at a discount and the discount had been charged off and deducted from income then the premium (purchase price in excess of par) may be deducted. [Any part of the discount, however, that had been charged off prior to the incidence of the Excise Tax (January 1, 1909), is not again deductible from income.] (2).

If the discount had been prorated over a period of years and at the time of redemption all the discount had not been charged off, then the difference between the purchase price and the selling price plus the discount charged off may be deducted. (3)

If the bonds were sold at a premium and the premium had been reported as a profit in an income tax return, then the premium paid in the redemption would be deductible as a loss (4).

Example (1):		
Bonds redeemed (purchased) at		$1,050.00
Sold at		1,000.00
Would permit of a deductible loss of		$ 50.00
Example (2):		
Bonds purchased at		$1,050.00
Sold at	$ 900.00	
Plus discount charged to Profit and Loss Account	100.00	
Par Value		1,000.00
Would result in a deductible loss of		$ 50.00

Example (3):		
Bonds purchased at		$1,050.00
Sold at	$ 900.00	
Plus discount prorated and charged to Profit and Loss Account	80.00	
Selling price plus prorated discount		980.00
Would permit of a deductible loss of		$ 70.00
Example (4):		
Bonds purchased at		$1,050.00
Sold at	$1,100.00	
Less premium credited to Profit and Loss Account and returned as income	100.00	
		$1,000.00
Would permit of a deductible loss of		$ 50.00

Discount on Bonds.

In Baldwin Locomotive Works *v.* McCoach (221 Fed. 59) it was held that discount allowed in the sale of bonds of the issuing corporation is not an expense of the corporation until the time of maturity of the bonds and, therefore, should be apportioned or prorated over the period of existence of the bonds.

> In the case of a corporation selling its own bonds at a discount the amount of the discount should be prorated over the life of the bonds and the proportionate part of such discount applicable to each year during the life of the bonds, constitutes an allowable deduction from the gross income of such year. The deduction from gross income in the case of twenty-year bonds would be one-twentieth of the aggregate amount of the discount on the bonds sold. (T. D. 2137.)

Discount on Bonds Charged off Prior to 1909.

Where the discount on the sale of bonds had been charged off on the books of account prior to the incidence of the Excise Tax (January 1, 1909) such discount cannot be deducted from the taxable income of a subsequent year.

> Discount on bonds issued prior to the year 1909, if such discount was charged against the income of the year in which the bonds were sold, is held not to be deductible from

the income of subsequent years, for the reason that the charging off prior to January 1, 1909, of the entire amount of the discount constitutes a closed transaction, and such transaction cannot be reopened for the purpose of reducing the taxable income of a corporation by deducting therefrom an aliquot part of the discount. (T. D. 2137.)

Premiums Life Insurance Partners Corporations.

By amendment of Treasury Department rulings and by Act of October 3, 1917, premiums paid on policies of insurance on the lives of partners in favor of a partnership, or on the lives of officers or employees in favor of corporations are not now deductible as expenses. Hereafter, such premiums may only be deducted from the gross proceeds of the policy, when received, the balance being returnable as income.

In cases where deductions have heretofore been made, the total premiums paid may only be deducted from the proceeds of the policy to the extent that premiums have not already been deducted. For example:

Amount received from insurance company upon policy		$10,000.00
Total premiums paid.....	$8,000.00	
Less, premiums deducted from income tax returns	500.00	
		7,500.00
Returnable as income.....		$ 2,500.00

The following Treasury Decision, issued August 30, 1917, with respect to corporations, is also applicable to partnerships:

"To Collectors of Internal Revenue:

"Treasury Decision 2090 in so far as it authorized corporations to deduct from gross income the annual premiums paid on policies insuring the lives of officers or employees in favor of such corporations, is hereby modified to the extent that instead of the corporations, carrying such insurance, being permitted to deduct from gross income of the year, in which paid, the amount of the annual premium payments, they will hereafter be permitted to deduct from the gross proceeds, when received, of any policies of which the corporations are the beneficiaries, the entire amount of the premiums paid during the term of the policies, less any

premium payments which, under the former ruling, have been deducted from gross income in any return of annual net income, and the net proceeds of the policies, thus ascertained, will be returned as taxable income of the year in which received."

W. H. OSBORN,
Commissioner of Internal Revenue.

Bonuses.

The test of deductibility of bonuses, as gathered from several rulings by the Department, seems to rest upon the question of contractual relation of employer and employee. It is not essential that there should be an express contract for extra compensation; one that is implied by the relations of the parties is sufficient to establish the right of deduction. Additional compensation, for example, paid to employees as extra compensation for services rendered, is a proper deduction from gross income of the employer. A gratuity or gift, however, for which no service has been rendered, such as Christmas gifts or voluntary contributions, is not deductible. But a payment by an employer to the employee, irrespective of when made, during the holiday or any other season of the year, in consideration of services rendered, as extra compensation, is deductible in the return of the employer. Such compensation, inclusive of the regular wages and the bonus, must be a reasonable compensation for the service rendered. A bonus paid, by reason of a prosperous season, is a distribution of profits and not deductible.

Many concerns have adopted the policy of paying to their employees, at regular intervals, sums in addition to their fixed wages or salaries. In such cases the employees have become accustomed to receiving the additional remuneration, look forward to and reasonably consider it as a part of their compensation. Such payments are deductible as expenses.

This subject is comprehensively dealt with in a letter of instructions to Collectors issued by the Office of the Commissioner of Internal Revenue in January, 1916, as follows:

"In order to establish uniformity and to facilitate the work of the internal revenue officers who are engaged in the examination of books for the verification of the returns of

annual net income made pursuant to the requirements of the Federal income tax law, you are informed that in all cases wherein special payments, often designated as bonuses, are made to officers or employees of corporations pursuant to a contract, express or implied, as additional compensation for services rendered, which payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered, such payments may be regarded as a part of the wage or hire of the officer or employee, and, as such may allowably be deducted from gross income as a business expense.

"A long-time practice, regularly employed, of paying to employees certain sums in addition to the stipulated salaries, constitutes a condition, if not a contract, under which the employees may reasonably expect, for the greater or better service which they render, additional pay, and if, in fact, such payments are made as additional compensation for services actually rendered, and if such payments, when added to the stipulated salaries, do not exceed a reasonable compensation, such payments, or bonuses may be treated as an 'ordinary and necessary expense of operation,' and, as such, deducted from gross income.

"This ruling contemplates that such payments are conditioned upon the services rendered by the employees and not upon the earnings of the corporation. If it should appear that the additional or special payments are dependent upon the earnings of the company, rather than upon the services rendered, or if such payments are made only occasionally, and then, at the option of the corporation as a sort of thank offering because of a prosperous year, and not in pursuance of a fixed policy or practice, or any contract, express or implied, it will be held that such payments are gratuities and, as such, are not properly deductible from gross income.

"This ruling is not intended to authorize in any case the deduction from gross income of amounts paid to employees or others as 'Christmas gifts,' even though it has been the practice of the corporation to make such gifts. These are held to be voluntary contributions or donations, and, as such, are not deductible.

"In determining whether or not the special payments above referred to are deductible, internal revenue officers will be guided by the facts as to whether or not such payments are made pursuant to a contract, express or implied,

or to a fixed policy or practice, and whether or not they represent compensation for additional or more efficient service rendered, and whether or not such special payments, when added to the stipulated salary or wage, exceed a reasonable compensation.

"Amounts paid to an officer or employee, who is a stockholder, in excess of a reasonable compensation for his services, will be treated as in the nature of dividends, a return upon his investment, and such amounts will not be deductible."

Bonuses that are deductible in the return of the employer must be included in the return of the recipient employee if he is required to make a return, and a gift or gratuity that is not deductible in the return of the employer need not be reported in the return of the employee. Gifts are not taxable as income.

Local Benefits. Taxes for grading of property, paving, sewerage and similar local improvements are capital expenditures and not deductible from income.

Taxes Paid by Tenant. Taxes paid by a corporation as tenant of rented property should be deducted in the return as rent paid.

Salaries of National Guardsmen. A corporation continuing to pay the salary of an employee doing duty as a National Guardsman in the service of the United States is permitted to deduct the salary paid to such employee in its return of annual net income.

Pensions. Amounts paid to retired employees or to their families, or those dependent upon them, in the nature of pensions, are deductible from gross income as expenses.

Salesmen's Expenses. It has been held that salesmen's expenses in the nature of entertainment of customers, incurred for business purposes, are deductible items.

So-called spending or treating money actually advanced by corporations to their traveling salesmen as a part of selling expense of the product of such corporations is an allowable deduction in a return of income by such corporation. There must be some showing that all the allowance claimed as a deduction was actually expended for the purpose for which the allowance was made, namely, the selling of the product of the corporation in question. (T. D. 2090.)

Money received for service connections and pipe extensions are not permitted to be deducted from the gross amount of the income, for they do not come within any of the permitted classes of deductions mentioned in the statute. Moneys so expended are invested in permanent improvements, which tend to enhance the rental and the market value of the water system. (238 Fed. 329.) **Service Connections, Pipe Extensions of Water Company.**

Payments, under contract, by public utilities to State or municipal governments for privileges or franchises under which such public utilities operate are necessary expenses and properly deducted from gross income. **Payments to Government by Public Utility.**

In case of a public utility constructed, operated, or maintained under contract with any city (State), Territory, or the District of Columbia, or a city where a portion of the net earnings of such public utility is payable under such contract to the State, Territory, etc., the amount so paid may be deducted by the public utility operating under such contract as an "expense of business." (T. D. 2090.)

Losses sustained by reason of defalcation or embezzlement are deductible items. It has been held, however, in the case of United States *v.* The Cleveland, Cincinnati, Chicago and St. Louis Railway Co., decided February 23, 1916, in the U. S. District Court, Southern District of Ohio, that such losses shall be deductible only in the year that the defalcation or embezzlement occurs. Should such loss or losses not be discovered until a subsequent year they would not then be deductible. "The time of discovery of a loss bears no relation to the date the loss was sustained. The loss was sustained when the theft occurred, although the defendant did not know at the time of the depletion of its assets." **Defalcation, Embezzlement.**

The organization and incorporation expenses of new enterprises are usually charged to a separate account in the ledger. Where such expenses amount to a considerable sum it has not been unusual to prorate the same, as expense, over a period of years, according to the **Organization Expenses.**

judgment of the board of directors. By ruling of the Department, the deduction of such "organization expenses" is now prohibited. It is held that such payments are capital expenditures of such character as not to be subject to depreciation or reduction for income tax purposes.

"WASHINGTON, D. C., *June* 11, 1917.

"*To Collectors of Internal Revenue:*

"Numerous inquiries have been made of this office with respect to the treatment by corporations in their returns of annual net income of what are known and commonly designated as 'organization expenses'—that is, attorneys' and accountants' fees, together with fees paid to the State authorities prior to, or coincident with, the securing of a charter and the incorporation of the company.

"In the absence of a formal and definite ruling on this question, there appears to have been some conflict in the holdings and instructions issued by this office in regard to this matter. Therefore, in order to make definite the position of the bureau and to promote consistency, it is held that 'organization expenses' constitute a capital investment, such expenses being offset by the asset value of the corporate franchise, an intangible asset of a somewhat permanent character and in many instances of substantial value. Such expenses are very similar in character to the discount at which the stock issued by the company is being sold, the only effect of such expenses and discounts being to reduce the amount of capital available for use and employment in the business of the corporation. The discount at which the stock is sold is not a loss sustained within the meaning of the law, and therefore not deductible. Likewise 'organization expenses'—that is to say, expenses incident to and connected with the incorporation and organization of the company—are not 'ordinary and necessary expenses of maintenance and operation' which are the only 'expenses' authorized by the income tax law to be deducted from gross income.

"Hence, it is held that 'organization expenses' do not constitute an allowable deduction from gross income of any taxable year, nor do such expenses constitute a proper item to be added to the cost of any physical property to be pro-

vided for through the authorized annual allowance for depreciation.

"W. H. OSBORN,
"*Commissioner of Internal Revenue.*"

Lobbying and Campaign Expenses.

By ruling of the Department it has been held that lobbying expenses and campaign contributions are not deductible. These, at any rate, are illegal expenses and would not be apt to appear upon corporate books of account.

Sums of money expended for lobbying purposes and contributions for campaign expenses are held not to be an ordinary and necessary expense in operation and maintenance of the business of a corporation, and are, therefore, not deductible from gross income in arriving at the net income upon which the income tax is computed. (T. D. 2137.)

Deductions Insurance Companies.

Additions to reserve funds of insurance companies, as required by law, and amounts paid on policy and annuity contracts, other than dividends, are deductible from gross income. [Law, Section 12 (a) 2.]

(a) Under item 5 (a) (1916) of the return form, the insurance company may take credit for all losses actually sustained during the year and not compensated by insurance or otherwise, including losses resulting from the sale or maturity of securities or other assets; also losses from agency balances, or other accounts, charged off as worthless; losses by defalcation; premium notes voided by lapse, when such notes shall have been included in gross income. This item will not, however, include payments on policy contracts.

(b) In this item may be deducted actual losses sustained within the year by reason of the depreciation of property, which shall have been so entered on the books of the company as to constitute a liability against its assets. An arbitrary depreciation deduction claimed in the return, but not evidenced by book entry, can not be allowed.

(c) In this item credit will be taken for all death, disability, or other policy claims, including fire, accident, and

liability losses, matured endowments, annuities, payments on instalment policies, surrender values, and all claims actually paid under the terms of policy contracts. Salvage need not be included in gross income if deducted in ascertaining the net amount paid for losses under policy contracts. Reserves covering liabilities for losses incurred, reported, resisted, adjusted or unadjusted but not paid, can not be deducted from gross income under this or any other item of the return.

(d) The reserve funds of insurance companies to be considered in computing the deductible net addition to reserve funds are held to include only the reinsurance reserve and the reserve for supplementary contracts required by law in the case of life insurance companies, the unearned premium reserves required by law in the case of fire, marine, accident, liability, and other insurance companies, and only such other reserves as are specifically required by the statutes of a State within which the company making the return is doing business. The reserves used in computing the net addition must not include the reserve on any policies the premiums on which have not been accounted for in gross income. For the purpose of this deduction, the net addition is the excess of the reserve at the end of the year over that at the beginning of the year and may be based upon the highest authorized reserve required by any State in which the company making the return does business. (Art. 147, Reg. 33.)

Assessment Insurance Companies.

Domestic and foreign assessment insurance companies are permitted to deduct from gross income amounts deposited with State officers as additions to guarantee or reserve funds, required by law. [Law, Section 12 (c).]

Deductions Allowed Foreign Corporations.

A foreign corporation is allowed to deduct: All ordinary and necessary expenses actually paid within the United States; losses actually sustained within the year in its business or trade, within the United States, not compensated for by insurance, or otherwise; also, reasonable allowance for depreciation and depletion of properties within the United States.

The deductions allowed to foreign corporations as necessary expenses, actual losses, depreciation and depletion, are the

same as those allowed to a domestic corporation, except that only such expenses, losses, depreciation, depletion, etc., as occur in connection with the business of such foreign corporation within the United States are allowed.

The provisions with respect to permanent improvements, betterments and expense of restoring property, are applicable to foreign corporations.

The amount on which interest is allowed to foreign corporations shall not exceed such part of the entire paid-up capital stock outstanding at the close of the year, and one-half of its interest-bearing indebtedness then outstanding, "which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States."

Taxes paid by a foreign corporation within the United States are deductible, excepting income taxes, excess profits taxes and those assessed against local benefits.

CHAPTER V

WAR EXCESS PROFITS TAX

War Measure. Administration.

The War Excess Profits Tax Law purports to impose a tax upon income in excess of normal profits as measured by three prewar years, namely, 1911, 1912 and 1913, with limitations as to what shall constitute "normal profits." In its very essence, however, its name is a misnomer; it is essentially not a "war excess profits tax" because its effect is not limited to war or exceptional profits. Enterprises that were prosperous prior to the war are nevertheless taxed to the same extent as are those that did not exist prior to the war, brought about by reason of the fixed maximum allowance in lieu of prewar income. As a matter of fact many old established concerns, doing a prosperous business on a comparatively small capital are discriminated against by the limitation of deductions based upon capital as defined by the law. The Act must be looked upon as an exigency of the Government; although in some respects inequitable, not so made by design of its makers, but by reason of the multiform ramifications of business and capital that could not be preconceived by the Legislators in the time within which the measure had to be prepared and enacted in order to render it applicable to incomes of the year 1917. The Bill contains some inconsistencies, which, undoubtedly, will be remedied by Congress, but the remedial legislation, it is believed, cannot now be made effective as to returns for the year 1917. The best that can be hoped for, for the present, is such alleviatory regulation as the Treasury Department may have power to grant in the administration of the law as it exists. No doubt there will be matters in respect of which administrative regulation will be ineffectual, but, from assurances of the Commissioner of Internal Revenue, unofficially stated, questions arising under the law will not be dealt with in a narrow way but in a broad and constructive way. This refers, of course, only to matters that are not clearly

understandable, or questions of discrimination; matters that are clear, mandatory and without ambiguity, will be rigidly enforced.

Who is Subject to Tax.

All individuals, partnerships and corporations, joint-stock companies or associations and insurance companies engaged in trade or business, professions or occupations in the United States (except those specifically exempted by law) are subject to the Excess Profits Tax upon their entire net income, less the deductions to which they are respectively entitled.

Nonresident aliens and nonresident foreign partnerships and corporations are taxable only on income derived from sources within the United States but without any exemption.

The tax is applicable to all trades and businesses of whatever description, whether continuously carried on or not, except:

(a) Compensation of officers and employees of the United States, or any State, Territory, or the District of Columbia, or any local subdivision thereof;

(b) Organizations exempt under the Income Tax Act of September 8, 1916, and individuals or partnerships coming within the same description or doing the same business;

(c) Income from the business of life, health and accident insurance combined in one policy issued on the weekly premium payment plan.

By statutory provision the terms "trade" and "business" include professions and occupations, and by ruling of the Treasury Department, employment under a salary, is comprehended in the term "occupation."

Hence, all individuals, partnerships and corporations engaged in any trade or business, profession or occupation, including persons compensated by salary, are subject to the Excess Profits Tax.

Exempt Organizations.

The exemption of certain classes of associations from income taxes and excess profits taxes applies also to individuals, partnerships and corporations carrying on the same business or coming within the same description as those specifically enumerated in the Act of September 8, 1916. (See page 84.)

The Excess Profits Tax is assessed upon the net income as determined for income tax purposes, less a deduction of an

Principle of Tax Deductions. Exemptions. amount for normal or prewar profits (not less than 7 or more than 9 per cent. of the invested capital), and an exemption of $3,000 to corporations and $6,000 to individuals and partnerships, respectively.

Incidence of Tax. The tax is effective as of January 1, 1917.

The Excess Profits Tax Law is contained in the War Revenue Act of October 3, 1917, and is designated therein as Title II, comprising Sections 200 to 214, inclusive. As designated by its title, it is a war measure but not necessarily limited in its duration to the time that the war lasts. According to the proposed War Revenue Bill passed by the Senate on September 10, 1917 (not acceptable to the House), it was intended that the "War Income Tax" and the "War Profits Tax," contained therein, should only be additional taxes upon incomes "during the present war." That provision was omitted from the final draft of the measure prepared by the Joint Conference Committee of the Senate and the House, and, as the Act finally became law on October 3, 1917, no reference was made therein to its duration. From this omission one may draw the conclusion that the war taxes will remain operative until after the close of the present war and so long as the Federal Government requires revenue from income taxation in addition to that provided for in the Federal Income Tax Law enacted September 8, 1916, now effective.

Duration.

The Excess Profits Tax Law of March 3, 1917, effective against corporations and partnerships only, was repealed by the Act of October 3, 1917 (Section 214), and any taxes paid upon assessments made under the requirements of the old law will be credited on assessments under the new law. If no assessment results under the present law, or one of a lesser amount than that already paid, the excess payment will be refunded as a tax erroneously or illegally collected upon application made, as provided herein on page 17.

Old Tax Repealed.

Rates of Taxes Where Capital is Employed. The Excess Profits Tax as applied to business or trade employing capital is computed on the net income as shown by the income tax return in excess of deductions (prewar allowance and exemption) at rates as follows:

20 per cent. of the amount of the net income in excess of the deduction of prewar allowance and exemption, and not in excess of 15 per cent. of the invested capital for the taxable year;

25 per cent. of the amount of the net income in excess of 15 per cent. and not in excess of 20 per cent. of such capital;

35 per cent. of the amount of the net income in excess of 20 per cent. and not in excess of 25 per cent. of such capital;

45 per cent. of the amount of the net income in excess of 25 per cent. and not in excess of 33 per cent. of such capital; and

60 per cent. of the amount of the net income in excess of 33 per cent. of such capital.

The method of computation of the Excess Profits Tax rates upon the net income could also be stated as follows:

Not in excess of 15 per cent. of the capital invested, less the deductions of 7 per cent., 8 per cent. or 9 per cent. of the invested capital (as the case may be), plus $3,000 if a corporation or $6,000 if an individual or partnership	@ 20 per cent.
15 to 20 per cent. of capital invested	@ 25 " "
20 to 25 per cent. of capital invested	@ 35 " "
25 to 33 per cent. of capital invested	@ 45 " "
In excess of 33 per cent. of capital invested	@ 60 " "

Individuals, partnerships and corporations engaged in business or trade, professions or occupations, having no invested capital or not more than a nominal capital are subject to a flat excess profits tax of 8 per cent. upon their net income less an exemption in the case of a domestic corporation of $3,000, and, in the case of a domestic partnership or a resident or citizen of the United States, of $6,000.

Rate of Tax Nominal Capital.

By the term "taxable year" is meant the calendar year, the twelve months ending December 31st, except that in case a corporation or partnership has designated its own fiscal year it means such fiscal year. Inasmuch as the Excess Profits Tax is effective as of January 1, 1917, corporations and partnerships using their own fiscal year must appor-

Taxable Year.

tion the income of period January 1st to the end of the fiscal year in 1917. The tax for such portion of the fiscal year falling within the year 1917 will be the proportion which the time from January 1, 1917, to the end of the fiscal year bears to the entire fiscal year. For example, if the fiscal year ends on June 30, 1917, six months falling in the year 1917, the Excess Profits Tax will be computed on six-twelfths or one-half of the total net income for the fiscal year. In such case the exemption of $3,000 or $6,000, respectively, must also be prorated in the same proportion.

Prewar Period.

By the term "prewar period" is meant the calendar years 1911, 1912 and 1913. If a partnership or corporation was not in existence or an individual was not engaged in business or trade during all of these years then such of them as the partnership or corporation was in existence or an individual was engaged in business will comprise the "prewar period." The wording of the law, namely, "as many of such years during the whole of which the corporation or partnership was in existence or the individual was engaged in the trade or business" would indicate that a part of a year is insufficient.

Returns of Citizens. Resident Aliens. Domestic Corporations.

The Excess Profits Tax returns of citizens, resident aliens and domestic corporations, will, in each case, respectively, comprise a part of the annual return of net income.

Returns of Nonresident Aliens and Foreign Corporations.

Nonresident alien individuals and foreign corporations are required to file returns of income from all sources within the United States regardless of amount received and such returns will provide, as a component part thereof, for the required data upon which the Excess Profits Tax will be assessed. No tax is imposed, however, if the net income is less than $3,000.

Returns of Domestic Partnership.

Domestic partnerships, which are not required to make returns of net income under the Income Tax Act of September 8, 1916, or the War Income Tax Law of October 3, 1917, unless ordered so to do by the Commissioner of Internal Revenue, must make returns under the Excess Profits Tax Law if their net income is $6,000 or more for the taxable year.

Foreign partnerships are not required to make returns unless their net income from sources within the United

States, during the taxable year, amounts to $3,000 or more. **Returns of Foreign Partnerships.**

The requirements of the Income Tax Law as to due date of filing (March 1st), and as to extensions of time, are applicable to the Excess Profits Tax. **Due Date of Filing Returns.**

All provisions of the Income Tax Law with respect to penalties for failure to make returns, for making false or fraudulent returns, etc., are made applicable to the War Excess Profits Tax. **Penalties.**

Excess Profits Taxes imposed upon partnerships should be apportioned among the partners according to their respective interests and deducted from their individual income tax returns. **Taxes. Partnerships.**

Section 202 of the Excess Profits Tax Law provides that no tax shall be imposed in the case of a foreign partnership the net income of which is less than $3,000 during the taxable year. By Section 211 it is required that all foreign partnerships having a net income of $3,000 or more for the taxable year, shall render a return for such year. The law does not appear to provide for an exemption to foreign partnerships earning and reporting an income in excess of $3,000. There would be no equity in taxing a partnership that had a net income of $3,100 and allowing another, earning $2,900 to go untaxed. Besides, this method is not in consonance with the general tenor of the law. This inconsistency will no doubt be remedied by legislation but whether that can be accomplished to become effective for the year 1917 is problematical. Those affected by the inequality should inquire of the Commissioner of Internal Revenue as to what regulation, if any, he has been able to make in the premises. **Inequity in Case of Foreign Partnership.**

The Department will require returns of net income for the prewar years from which to compute and verify the percentage of net income claimed as deductions based on invested capital.[1] **Returns of Net Income for Prewar Period and Taxable Year of Corporations.**

[1] If the taxpayer accepts the minimum percentage (7%) by which to compute the deduction for the taxable year, no return of net income or of invested capital for the prewar year will be required. (T. D. 2614, Dec. 20, 1917.) See page 172.

The net income of corporations for the prewar period and the taxable year, shall be ascertained and returned upon the bases, as follows:

For 1911 and 1912 [1]

The net income for the years 1911 and 1912 shall be returned for the calendar years on the basis of requirements under the Act of August 5, 1909, except that Federal income taxes paid within the year shall be included.

For 1913 [2]

The net income for the year 1913 shall be returned for the calendar year on the basis of requirements under the Act of October 3, 1913, except that Federal income taxes paid within the year shall be included and, except that the amounts of dividends received upon the stock or from the net earnings of other corporations, subject to the tax applicable to 1913, shall be deducted.

For the Taxable Year

The net income for the taxable year (1917 and thereafter) shall be returned on the basis of requirements under the Act of September 8, 1916, as amended by the Act of October 3, 1917, except that the amounts of dividends received upon the stock or from the earnings of other corporations, subject to the income tax, shall be deducted.

In respect of the returns required for the years 1911, 1912 and 1913, corporations that made their returns for the calendar years, can use the substance of returns that were filed for these years except that Federal income taxes paid within these years should not be deducted from income, and in the return for 1913 dividends received from taxable corporations should not be included as income.

Limited Partnerships.

Limited partnerships will be required to make returns under the provisions of law applicable to corporations and are entitled to deductions accorded to corporations.

[1] The law is contained in Appendix, page 305.

[2] The law is contained in Appendix, page 312.

The net income of partnerships and individuals shall be ascertained and returned for the calendar years 1911, 1912 and 1913, and for the taxable year, upon the basis of requirements of the Act of September 8, 1916, as amended, except that dividends received upon the stock or from the net earnings of corporations which were taxable upon their net income, shall not be included as income. Domestic partnerships will be entitled to all deductions to which citizens or residents are, by law, entitled, and foreign partnerships will be entitled to the same deductions to which non-resident aliens are entitled.

Net Income for Prewar Period and Taxable Year of Individuals and Partnerships.

In Senator Simmons' explanation of the War Revenue Act before the Senate, on October 2, 1917, he defined and illustrated the word "occupation" as including the salary of a corporate officer, in language as follows:

Occupation Salary.

> "I think that the president of a corporation is engaged in an occupation. We must give some meaning to the word 'occupation' as used in the bill. If it means no more than 'trade' or 'business' there would be no reason for having included it in the bill. It seems to me that the Treasury must construe the bill—and the courts will, in my opinion, sustain them, as meaning that all salaries, other than those of employees of the Government, national, State, or municipal, are liable to this tax, whether it be the salary of the president, the attorney, the doctor, or any other employee of the corporation, subject, of course to the flat exemption of $6,000."

The question was asked Mr. Kitchin in the House of Representatives whether, in his opinion, a person who owns several thousand acres of land, which he rents, would pay an excess profits tax. Mr. Kitchin's answer was:

Landowner. Income.

> "There is some doubt as to this, but I am inclined to believe that he would pay an excess profits tax. He would probably be construed as being in the business of renting land."

This seems to be a logical conclusion and no doubt the Department will so rule. Where, however, a person incidentally

rents a farm or parcel of land or a building, and such renting is not his business or part of his business, the income therefrom would not then be subject to the excess profits tax.

Mines, Oil Wells, Timber Lands.

On the question of the application of the excess profits tax to mines, oil wells and timber lands, an interesting explanation was made in the House of Representatives by Representative Kitchin bearing particularly upon what constitutes profits from operations. The principle enunciated can be applied to all cases where natural resources are depleted or subjected to exhaustion.

> "MR. CAMPBELL of Kansas. I have a great many oil wells and coal mines in my district, and the owners of the property tell me that when they are taking out oil or coal they are exhausting their principal, and they have wondered if the excess profits applied to them when they are taking out their product and exhausting their principal.
>
> "MR. KITCHIN. I am glad the gentleman mentioned that.
>
> "MR. CAMPBELL of Kansas. What did the conferees conclude as to that?
>
> "MR. KITCHIN. We did not take care of that proposition. Let me say that I have had owners of oil wells and of coal and zinc mines and lumbermen tell me that each day in carrying on their business they are exhausting their capital and ought to have a reduction in some way on their excess-profits tax on this account. They are mistaken. They are not exhausting their capital each day, but instead they are getting their capital back each day. For instance, suppose I put $100,000 into standing timber costing, say, $5 a thousand feet, and erect a sawmill and cut it into lumber. Every time I cut a thousand feet I charge that $5 up as cost of raw material, along with the cost of labor and other expenses. When I sell that thousand feet of lumber I add the cost of the standing timber, labor cost, and other expenses to the price for which sold. Five dollars of my principal is returned to me with a profit on it upon the sale of each thousand feet. Instead of exhausting their capital daily, a part of their capital is each day being returned to them to be again invested.
>
> "MR. CAMPBELL of Kansas. But is it a profit?
>
> "MR. KITCHIN. They get their capital back and the profit, too.

"MR. CAMPBELL of Kansas. Is it a profit when they are taking their capital out of the mines?

"MR. KITCHIN. For instance, a man puts $300,000 into a coal mine, and the coal in the mine, say, stands him 5 cents a ton. He begins to mine and sell the coal. In the price of every ton he sells is included the cost of the coal in the mine, the cost of labor, overhead charges, and all other expense, and his profit. On every ton sold he gets back that part of his capital which he invested in or paid for that ton of coal at the mine.

"MR. CAMPBELL of Kansas. But suppose he has 160 acres of coal land, and he has mined all of that 160 acres, and it is completely exhausted?

"MR. KITCHIN. He has got his entire capital back. His mine is exhausted, but the capital he put into it has been returned to him from time to time as he mined and sold the coal.

"MR. CAMPBELL of Kansas. But is that charged to him as profits.

"MR. KITCHIN. The income tax law and this bill permit him to deduct the cost of that coal, in getting at his profits or income that year for the purpose of the tax. He deducts that, deducts the overhead charges, labor, and all other expense in determining the profits or income in his business.

"MR. CAMPBELL of Kansas. Here is a man who has an oil well that cost him $20,000. Every time he takes 20 barrels of oil out of that well he exhausts the value of his investment, does he not?

"MR. KITCHIN. He exhausts that much of the oil in the well and the well is worth that much less, but instead of exhausting his capital put into it, he has had it returned to him at every sale of a barrel of oil to the extent of the cost to him of the oil in the well. Suppose the oil in which his capital was invested cost him at the rate of 25 cents a barrel; every barrel he takes out, when he sells it, he gets back 25 cents of his capital that he has put in. When he has exhausted the well he has had returned to him the $20,000 in the price he received for the oil. Suppose I buy standing timber for $100,000 and the next day I sell it for $150,000. I have sold all of it in one sale and got my capital back the next day and $50,000 profit. Suppose I cut it up into lumber and sell it in that way, taking a year in which to cut it; each day I cut and sell I get part of my capital back.

When I have sold it all I have all my capital back and the profits on my investment. As a matter of justice one should not have a deduction on the whole amount of original capital when in the nature of the business his capital is from time to time returned to him as in the case of timber, oil, and mining business, and such returned capital should not be used as a basis of deduction."

(*Congressional Record*, October 16, 1917.)

Income From Investments. Income received by individuals from stocks and bonds, held as investments, is not subject to the Excess Profits Tax.

This exception in the operation of the tax has brought forth a great deal of criticism. The unfairness of taxing industry and allowing income from investments in securities to go untaxed was emphasized in the Senate on October 2, 1917, when the present law was under consideration, in a speech by Senator Wadsworth, replied to by Senator Simmons. Senator Simmons' response evinces his accord in the arguments presented and indicates that time did not permit of effecting changes in which he himself concurred. The following extracts from the *Congressional Record* of October 16, 1917, are appended merely to show that in the preparation of the Bill, even those engaged in its making were not permitted, by limitation of time, to correct inequities of which they had knowledge and to bespeak impending material changes in the principles of the present income and excess profits taxes.

"MR. WADSWORTH. I do desire, however, to take this opportunity to say that section 209 emphasizes very clearly, I think, a grave injustice which is done by our tax laws, an injustice inflicted, comparatively speaking, upon the man who earns his income by his own efforts as compared with the man who does not earn his income at all, but merely sits at a desk and clips coupons or cashes dividend checks. The man who is so fortunate as to inherit an invested fortune, as we all know, unless he is otherwise minded, may sit in his office and clip the coupons and cash the dividend checks and live upon the proceeds without being of any particular use to the community. In fact, he may pass his whole life as a drone. He is subject to the

individual income tax, and if his individual income, we will say, is $10,000, he will pay according to the rates fixed in this bill and according to the rates fixed in the statutes which are already upon the statute books.

"Now we will take the professional man, such as the physician or the dentist or the lawyer, who, by his own efforts, extending over a period of years and resultant upon an education which he may have earned for himself by working his way through a medical school or a law school, manages to reach the point in his profession where he earns $10,000 a year. He pays the individual income tax on that $10,000, and then this bill comes along and assesses him 8 per cent. on everything over $6,000 of his income in addition to the individual income tax he pays, so that he is penalized because he is a worker. If he had not earned the $10,000 he would only pay an individual income tax; but, having earned it by his own efforts, he pays more tax.

"Of course I realize that this thing can not be straightened out in a moment, and certainly my judgment upon it would not be infallible, nor is it entirely certain that my conclusions are clear; but let me say to the Senator from North Carolina and to other Senators who have been interested in this question of taxation that sooner or later we must come to the point in the assessment of Federal taxes against individual citizens, whether they be in the form of individual income taxes or otherwise, where we shall discriminate between the earned and the unearned incomes.

"MR. SIMMONS. I agree with the Senator absolutely in that proposition.

"MR. WADSWORTH. I called attention in the Sixty-fourth Congress to the fact that in my humble judgment the most glaring defect in our imposition of the individual income tax was the fact that it made no distinction between the drone and the worker. It taxed them exactly alike. This bill makes the condition infinitely worse. It taxes the worker infinitely more heavily than it does the drone.

"I know it is too late to cure the situation, and I realize the theory on which the committee has proceeded—that individuals engaged in business should pay a profits tax, whether we call it an excess-profits tax or a war-profit tax,

just as a partnership or a corporation engaged in business is required to pay such a tax; but we still leave uncured and uncorrected the injustice done in the income tax.

"MR. SIMMONS. I want to state to the Senator that the very suggestion he is making now was made to the committee and received some consideration; but we considered that the matter had gone too far; that the time was too short for us to undertake to change the method of taxation as radically as his suggestion would have required.

"MR. WADSWORTH. I can well understand that; but I want to take this opportunity very briefly to emphasize that situation to the Senate in the hope that next year, or perhaps the year after, we will cure this situation, for it does seem to me to be a grave and a gross injustice to inflict a penalty upon industry and permit the drone, as I have used the expression before, to escape merely by the imposition of one tax."

(*Congressional Record*, October 16, 1917.)

Invested Capital of Taxable Year.

By "invested capital" is meant the average invested capital for the year, averaged monthly, except that the average invested capital for the taxable year is exclusive of undivided profits earned during the taxable year. Hence, the invested capital for the taxable year is the invested capital as at the first day of such taxable year plus any additional capital paid in during the taxable year averaged monthly.

Exclusions From Invested Capital.

The term "invested capital" does not include stocks, bonds (other than obligations of the United States) or other assets, the income from which is not subject to the excess profits tax, nor money or other property borrowed.

Invested Capital of Partnership or Corporations.

Liabilities may not be included as capital; for example: accounts payable, bills payable (notes), bonds payable, or loans of any kind.[1]

Invested capital, in the case of partnerships and corporations, includes:

(a) Actual cash paid in;

[1] Liabilities are a deduction from the assets (computed by limitation of law as to tangible and intangible property), in determining surplus, which latter, by law, is a part of invested capital.

(b) Actual cash value of tangible property paid in other than cash at the time of such payment;

(c) Paid in or earned surplus and undivided profit used or employed in the business, exclusive of undivided profits earned during the taxable year.

Tangible property[1] paid in other than cash for stock or shares in a corporation or partnership may be included as invested capital at an amount not in excess of the actual cash value thereof at the time of such payment. In case such tangible property was paid in prior to January 1, 1914, the actual cash value of such property as of January 1, 1914, may be included as invested capital, but in no case shall such actual cash value exceed the par value of the original stock or shares specifically issued therefor.

Value of Tangible Property Partnerships or Corporations.

The value at which patents and copyrights, paid for by stock or shares in a corporation or partnership, may be stated as invested capital, shall not exceed the actual cash value thereof at the time of such payment and shall not be in excess of the par value of such stock or shares at the time of such payment.

Patents, Copyrights, Partnership or Corporation.

Invested capital, in the case of an individual, includes:

(a) Actual cash paid into the trade or business;

(b) Actual cash value of tangible property paid into the trade or business, other than cash, at the time of such payment, except when the tangible property was paid in prior to January 1, 1914, the actual cash value of such property on that date shall be stated as invested capital.

Invested Capital of Individuals.

(c) Actual cash value of patents, copyrights, good will, trademarks, trade brands, franchises or other intangible property, not to exceed the actual cash value of the tangible property *bona fide* paid therefor at the time of such payment.

Invested Capital of Foreign Corporation or Partnership or Nonresident Alien.

In the case of a foreign corporation or partnership or of a nonresident alien individual the term "invested capital" means the proportion of the entire invested capital as defined in respect of domestic corporations and partnerships and citizens or resident

[1] For definition of "tangible property" see page 168.

aliens, which the net income from source within the United States bears to the entire net income from all sources within and without the United States.

Liberty Bonds, Invested Capital of Corporations and Partnerships.

Capital, surplus, or undivided profits (except undivided profits earned during the taxable year) invested in Liberty Bonds, or any other obligations of the United States, by corporations and partnerships, will be included in invested capital for purposes of computing deductions.

"Investments in obligations of the United States, including Liberty Bonds of both issues, made by a corporation or partnership from capital, surplus, or undivided profits will be included in invested capital for the purpose of computing the deduction and rate of taxation under the Excess Profits Tax Law; but undivided profits earned during the taxable year can not be included in invested capital." (T. D. 2541.)

Invested Capital. Books of Account.

The books of account of a trade or business are *prima facie* the best guide to the amount of capital invested, as well as to earnings, and are assumed to reflect the facts as to both. The book accounts entering into invested capital, however, are not conclusive as to what constitutes invested capital under the Excess Profits Tax Law. The Government has the right to go back of the books of account in order to verify the facts upon which the invested capital, as reflected by the books of account, are predicated. The fact that an asset actually exists and appears upon the ledger does not necessarily make it a part of invested capital; to be so included, it must conform to requirements of law as to value and manner of acquirement. Conversely, assets may exist which are justly a part of invested capital and yet do not appear upon the books of account. The real facts and not bookkeeping facts prevail in the valuation of assets for income tax purposes. (U. S. *v.* Guggenheim Exploration Co., 238 Fed. 231; Mitchell Bros. *v.* Doyle, 225 Fed. 437; Baldwin Locomotive Works *v.* McCoach, 215 Fed. 967.)

The value of capital stock of corporations as shown by "Capital Stock Tax Returns," where such value is based upon the outstanding capital stock plus surplus, as shown by the books of account, will be material but not conclusive as to invested capital; where the value of capital stock is declared upon the market value there is no relevancy.

In the ascertainment of invested capital of corporations the cost of property, tangible or intangible, is of predominant importance. In this connection it is worthy of note that, under the Excess Profits Tax Law, tangible property acquired by corporations and partnerships prior to January 1, 1914, shall be stated at the actual value as of that date, but not in excess of the par value of the stock or shares originally issued therefor; whereas, in the case of individuals the value of tangible property may be stated at the value as of January 1, 1914, without the limitation as to cost. This inhibition upon corporations and partnerships (unless the Treasury Department interprets the law differently) is discriminatory and inequitable.

As a matter of bookkeeping, it is not uncommon for prosperous concerns to write off capital assets or to carry them on the books at only nominal values. Where this has been the policy, it is suggested that the assets charged off or arbitrarily written down be reëstablished upon the books of account. This must be done consistently and with due regard to the manner in which the accounts were charged off or reduced. The amounts reëstablished in such accounts must be determined in strict conformity with the law prescribed as to tangible and intangible property. But whether or not such assets are reëstablished upon the books of account they may, nevertheless, be included in invested capital if the conditions as to their acquirement admit them as such items as are acceptable under the law. For example, good will that was actually purchased in the year 1910 for say, $100,000, which has since been written off against surplus may be included in the assets, provided that it was paid for in cash or property; if it was paid for in stock, then at the amount so paid but not in excess of 20 per cent. of the total capital stock outstanding on March 3, 1917, and not in excess of the par value of stock issued therefor; provided, in either case, that the good will exists at the time of claiming it as invested capital and that the corporation is then the owner thereof. In the case of trade-marks the same principles would be applicable. It is, of course, assumed that no part of the amounts written off on the accounts mentioned was deducted in the ascertainment of income for tax purposes. (Depreciation, or any other deduction on account of good will or trade-marks, is not a deductible item.)

In the case of tangible property having been arbitrarily written off by a corporation, the value at which such property may be reëstablished on the books and included in invested capital shall not exceed, if paid for in cash, the actual cash paid therefor; if paid for in stock, the actual cash value of such property paid in for stock at the time of such payment, not in excess of the par value of such stock issued therefor, and provided, in either case, if property was acquired prior to January 1, 1914, that the cash paid or cash value is not in excess of the actual cash value on January 1, 1914. Any part of the cost of property, so determined and limited, that has been charged off as depreciation or otherwise, and deducted from income for tax purposes, is no longer available as an asset to the amount so charged off. The depreciation charged off is evidence of a decrease in the value of the property depreciated, and for purposes of invested capital, the value has diminished by the amount so charged and deducted; "you cannot both eat your cake and have it." If, perchance, depreciation should have been deducted in excess of actual depreciation sustained, the amount deducted in excess cannot be offset except by stating the amount thereof as income, which, thereby, is made subject to income taxes. Where an amount is charged off in excess of the cost of property, such excess, by rulings of the Department, is required to be returned as income.

In a case where property was arbitrarily written off, in part or in whole, but was not deducted from income tax returns, the amount reinstated shall not exceed the difference between the actual value of the property at the time *as of which* the correcting entry is made and the balance at which it was carried on the books at such time. For example, if property purchased in the year 1905

cost	$10,0000
and on January 1, 1911, there had been charged off (not deducted from excise tax returns)	$ 9,000,
it would appear upon the books on January 1, 1911, at	$ 1,000;
Assuming that the property on January 1, 1911, was actually worth	$ 5,000,
the amount that may be reëstablished in the account cannot exceed the difference between the actual value as of that time and the amount at which it was then carried on the books, namely	$ 4,000

Furthermore, such adjustments must be made to affect the invested capital of prewar years, if the property had been acquired prior thereto or within that time, and not alone the invested capital of taxable years.

The amount of invested capital should be based upon actual values of property as at the time the capital is computed, subject to limitations of law as to such values.

"Nominal capital" is not defined in the law. The term is uncertain and vague. What may be nominal capital in one case may be real in another. **Nominal Capital.**

The term may be applied, however, with a reasonable degree of certainty, to particular classes of taxpayers. For example, those engaged in the practice of a profession, such as lawyers, doctors, dentists, teachers, architects, engineers and clergymen, will, undoubtedly, be classed as employing a nominal capital or not more than a nominal capital. A chemist or druggist, although engaged in a profession, usually conducts a mercantile business in connection therewith and employs actual capital. Where such capital is merely incidental, as that required for experimental purposes, the rate of tax applicable to nominal capital would apply. In cases where a profession is practiced only as an incident to the conduct of a mercantile or other business, however, as in the case of the druggist or chemist, an engineer actually engaged in construction operations and furnishing capital in connection therewith, an architect doing a building business, or any case where actual capital is employed in the operation of such business, the taxpayer is subject to the tax imposed on those employing more than a nominal capital. Where the differentiating line is to be drawn is a difficult problem. Hard and fast rules are practically impossible of equitable administration.

Representative Kitchin was asked a question in the House of Representatives bearing upon this subject by Representative Dallinger, as follows:

> "MR. DALLINGER. Section 209 uses the words 'nominal capital.' Suppose a family is incorporated for a small amount of capital, and all they have is a trade-mark or the good will of certain articles? Suppose they could sell to-day that trade-mark for half a million dollars and they are only

incorporated for $5,000? Would that come under that section?

"MR. KITCHIN. How much are they making?

"MR. DALLINGER. Suppose they are making net $100,000, and are only capitalized for $5,000.

"MR. KITCHIN. I would say that that was not more than a nominal capital in the case the gentleman puts, and the corporation would pay under section 209."

Whether Mr. Kitchin's reply is in consonance with the law is questionable, but his conclusion seems equitable. Under Section 207 (a) of the law, trade-marks and good will purchased prior to March 3, 1917, shall be stated at an amount not in excess of 20 per cent. of the total capital stock and at a value not to exceed "the actual cash value at the time of such purchase." On the other hand, the trade-mark or good will in the case at point may not have been paid for at its "cash value" at the time of its acquirement by the corporation. The corporation may have been formed only as a convenience to the members of the family, the stock issued, representing only relative interests or a measure of proportionate interests in property apart from the value of the property itself or the value of the respective interests. Close corporations by reason of economy of maintenance, are not uncommonly so capitalized. It may be said, therefore, that where the amount of capital stock is only nominal and not representative of the actual value of the property possessed by a corporation, as in the case passed upon by Mr. Kitchin, either the flat rate of 8 per cent. shall be imposed, or, the parties in interest may request that the corporation receive the benefit of a deduction based on the returns of representative corporations in a similar business, and pay the tax upon the graduated rates prescribed by law—as explained in the next paragraph.

Where Invested Capital Cannot be Determined.

In cases where actual capital is employed by an individual, partnership or a corporation, and the Secretary of the Treasury is unable satisfactorily to determine the amount of invested capital, the deduction in lieu of normal or prewar profits shall be:

The same proportion of the net income for the taxable year, which the average deduction for the calendar year of representa-

tive concerns in a like business without including the exemptions of $6,000 and $3,000, bears to the net income received by such representative concerns. For example, if in a certain line of business the Treasury Department finds, from summary computations made from returns of net income, the following facts:

Aggregate capital invested for taxable year	$30,000,000
Aggregate net profit for taxable year	6,000,000

The net profit would be 20 per cent. of the invested capital. The aggregate amount of deductions permitted by law, however, being limited to 9 per cent. of invested capital, would be only $2,700,000.

Based on these aggregate computations a concern in a similar business, of which the Secretary of the Treasury is unable to determine the invested capital, with a net profit of $25,000 would be entitled to a deduction in lieu of prewar profit of $11,250, computed as follows:

$2,700,000 : $6,000,000 :: ? : $25,000 =
(2,700,000 x 25,000) ÷ 6,000,000 = 11,250

or, on a percentage basis:

9 : 20 :: ? : 25,000 =
(9 x 25,000) ÷ 20 = $11,250

In addition to the deduction of $11,250 such concern would be entitled to the specific exemptions of $3,000 if a corporation, and $6,000 if an individual or partnership.

The law provides that the proportions between the deductions and net income in each trade or business shall be determined by the Commissioner of Internal Revenue in accordance with regulations prescribed by him and approved by the Secretary of the Treasury.

In case of the change of ownership, the reorganization or consolidation of a trade or business after March 3, 1917, if 50 per cent. or more of the ownership remains in the control of the same persons, corporations, or partnership, or any of them, then in computing the invested capital, the assets of such business which were transferred or received shall not be allowed any greater value than would have been allowed in determining the invested capital of the prior trade or business if there had been no trans-

Partial Change of Ownership.

fer, unless such assets were paid for in cash or tangible property and then not to exceed the actual cash or cash value of the tangible property paid therefor at the time of payment. (Law, Section 208.)

Reorganized or New Corporation.

Section 204 of the Excess Profits Tax Law states that a business although formally organized or reorganized on or after January 2, 1913, but which is "substantially a continuation of a trade or business carried on prior to that date" shall be deemed to have been in existence before that time, and the net income and invested capital of the predecessor will be deemed to have been its net income and invested capital.

The question as to what constitutes "substantially a continuation" is one that can only be answered by a consideration of the facts of each case. These facts would include: questions of continuity of parties in interest; whether the same kind of business was continued; at the same location, etc. A change in the amount of investment would not alter the case necessarily, because this is only used relatively in computing the percentage of prewar profit.

The question at point was discussed in the House of Representatives shortly before the War Revenue Bill was voted upon (October 1, 1917). Representative Kitchin, Chairman of the Ways and Means Committee, was explaining the terms and operation of the law when Representative Cooper of Wisconsin presented a concrete case of reorganization. The following is taken from the *Congressional Record* of October 16, 1917:

> "MR. COOPER of Wisconsin. The character of the Excess Profits Tax is somewhat difficult to ascertain from a casual reading of this very complicated bill, and therefore I ask this question, which has been submitted in perfect good faith by a very excellent gentleman: A corporation during the prewar period made an average profit of $3,000 a year. After the war began it bought out a competitor, borrowed $75,000 in money, and made a considerable investment in new buildings, and is capitalized for $125,000. This last year its profits were $15,000. Now how do you, under those circumstances, adjust the difference between the prewar period and the war period?

"MR. KITCHIN. Does the gentleman mean that the corporation was merged or reorganized during the war?

"MR. COOPER of Wisconsin. They made a new corporation entirely.

"MR. KITCHIN. There is a provision in the bill to take care of that. Where a corporation is reorganized with practically the same owners it is considered, so far as the percentage of deduction is concerned, a continuance of the business.

"MR. COOPER of Wisconsin. But there are new owners in it.

"MR. KITCHIN. I know, but there are also the old owners in it. If the old owners succeed to the new business, then they take the percentage that they had before the war, but if it is discontinued altogether, if the old owners gave up their business and got out, and an entirely new corporation was organized since the prewar period, then it would take an 8 per cent. deduction, as provided in the bill for new companies or business.

"MR. GREEN of Iowa. The prewar income is no longer the basis of taxation.

"MR. KITCHIN. It is no longer the basis of taxation, but it is still the basis of the deduction in a much more limited extent than was in the Senate amendments. There still exists a differential of 7 and 9 per cent. I am going to get to that and explain it as best I can.

"MR. COOPER of Wisconsin. It is exceedingly important in the case of this particular corporation, because for this $75,000 of new capital invested they gave notes payable monthly, and it requires a profit in order to meet those notes and amortize the debt.

"MR. KITCHEN. I will say to the gentleman that if there is a change of corporation, company, business, or ownership altogether, then it is a new company that was not in existence during the prewar period, and it would take the 8 per cent. deduction for the new business. That is, it would have an 8 per cent. deduction upon the capital invested by the new company plus a further deduction of $3,000. Then the rate of taxation would apply on the income in excess of the deduction.

"MR. COOPER of Wisconsin. Eight per cent. deduction on the capitalization.

"MR. KITCHIN. On the invested capital, surplus, and undivided profits, plus $3,000.

It is suggested that in cases presenting special questions such as that cited, a ruling thereon be obtained from the Collector of Internal Revenue.

Good Will, Trade-Marks, Franchises.

An essential condition to the inclusion as invested capital of good will, trade-marks, or franchise of a corporation or partnership, or other intangible property is that *bona fide* payment therefor must have been made in cash or tangible property and at a value not to exceed the actual cash or cash value of the property paid therefor at the time of payment, except:

That good will, trade-marks, trade brands, franchise of a corporation or partnership, or other intangible property purchased *bona fide* prior to March 3, 1917, with an interest or share in a partnership or with shares of capital stock of a corporation (issued prior to March 3, 1917) to an amount not in excess of 20 per cent., on that date, of the total interests or shares in the partnership or of the total outstanding capital stock of the corporation, may be included in invested capital but at a value not in excess of the actual cash value at the time of purchase or the par value of the stock issued therefor.

The effect of the limitation upon good will, trade-marks, trade brands and franchises paid for by capital stock of corporations, as invested capital, is that the stock must have been issued prior to March 3, 1917, and in good faith. (March 3, 1917, is the date of the enactment of the first Excess Profits Tax which was repealed by Act of October 3, 1917.) Furthermore, such stock may be included as invested capital only up to 20 per cent. of the total amount of capital stock of the corporation. Capital stock issued since March 3, 1917, for good will or intangible property, may not be included as invested capital.

Reserve Accounts, Reserve Funds.

A clear understanding of reserve accounts, how they are created and their respective functions, is quite necessary in order to determine whether or not a particular reserve constitutes a part of the invested capital.

A reserve account, ordinarily, is established by a charge to Profit and Loss Account [1] and a corresponding credit to the

[1] In practice, the charge is first made to an account designating the

Reserve Account. The charge to Profit and Loss Account effects a reduction of the profit for the period in which the reserve is created or added to. The credit to the Reserve remains an open balance either as a negative account (reduction of a property account) or, in the nature of a reservation of profits or surplus for particular or general purposes. For example, the amount set aside as a reserve for depreciation is, in effect, a reduction of profits and a corresponding reduction of the book value of the property depreciated. The same would be true of a reserve for loss on investments, reserve for bad debts or for depletion of natural resources. All of these reserves, in their creation or increase, result in a reduction of profits and may or may not have been deducted from returns of net income for tax purposes. To particularize, reserves for depreciation and depletion are deductible and the reserves for loss in investments and for bad debts are not deductible. In the nature of them, as stated, they are all created by a reduction of profits, tantamount to expenses, and effect reductions of surplus. On the other hand, a reserve set aside to equalize dividends or a reserve for amortization of bonds payable are not expenses and do not affect a reduction of profits. It may be stated, therefore, as a principle, that reserves created by a reduction of profits and deducted from income tax returns, do not constitute invested capital. Such reserves, so called, are merely reductions of the book value of property accounts to which they relate.[1]

Reserves for loss on investments or for bad debts, not being deductible items in income tax returns, were, in all likelihood, set aside only as a precautionary measure, to equalize profits, for example, or for some similar reason. Such reserves, in so far as they do not represent an actual reduction of the book value (value at which an asset appears upon the books of account) of the assets to which they relate, constitute, in the author's opinion, invested capital.

nature of the charge, as Depreciation, Bad Debts, Depletion, etc. Such account is then closed into Profit and Loss Account.

[1] A reduction of a reserve account, where the latter is found excessive, should be reported as income.

To illustrate:

Reserve for Depreciation.
Reserve for Depletion.

These are negative accounts that merely effect a reduction of the book value of the property accounts which they qualify, and, hence, do not constitute invested capital.

Reserve for Bad Debts.
Reserve for Loss on Investments.

Although the amounts credited to reserves of this class were charged to Profit and Loss Account and, on the books of account, effected a reduction of profits or surplus, if they were not deducted from income tax returns, they constitute, in the author's opinion, invested capital *to the extent that they are not required to meet the purposes for which they were created.* For example, in the case of bad debts:

The accounts receivable according to the ledger accounts amount to	$100,000.00
The good and collectible accounts amount to	98,000.00
Balance represents bad debts	$ 2,000.00
If there was an accumulated reserve for bad debts of	$ 10,000.00
The difference would represent an amount reserved in excess of requirements and would constitute invested capital, of	$ 8,000.00

Reserve for Amortization of Bonds Payable.
Reserve for Equalizing Dividends.
Reserve for Working Capital.

Reserves of this category would, ordinarily, be created by a charge to Surplus Account; they would not effect a reduction of earnings, and, hence, could not have been deducted in the ascertainment of net income for tax purposes. These reserves may be considered as in the nature of surplus and as such constitute invested capital.

A reserve fund, or more properly, a Reserve Fund Investment, is an investment fund created by reinvesting or setting aside cash or its equivalent. The establishment of such invest-

ment funds does not in any way affect income tax returns. Hence, reserve fund investments, such as all forms of sinking funds, if represented by specially invested funds or assets, constitute invested capital.

Deductions to Citizens, Residents, Domestic Corporations and Partnerships.

Citizens and residents of the United States and domestic corporations and partnerships, are entitled to a deduction in lieu of prewar income of the sum of:

(1) An amount equal to the same percentage of invested capital for the taxable year

which

the average amount of the annual net income of the trade or business during the prewar period

was

of the invested capital for the prewar period—but not less than 7 or more than 9 per cent. of the invested capital for the taxable year,

plus

(2) $3,000 to corporations,
$6,000 to citizens or residents,
$6,000 to partnerships.

EXAMPLE

A corporation had an invested capital during the prewar years of, respectively:

1911	$100,000
1912	105,000
1913	110,000
	3)$315,000

making an average capital for the prewar years of.....$105,000

The net incomes for the prewar years were:

1911	$ 10,250
1912	16,000
1913	21,000
	3)$ 47,250

making an average net income for the prewar years of ..$15,750

The percentage of the average net income for the prewar years was:

$15,750 + $105,000 = .15 = 15 per cent.

The average percentage being in excess of 9 per cent.[1] the corporation is entitled to the maximum deduction allowed by law, namely, 9 per cent.

Assuming that for the taxable year the corporation had an

Invested capital of		$200,000
and a net profit of		$ 40,000
it would be entitled to a deduction of 9 per cent. of		
$200,000	$18,000	
an exemption of	3,000	
making a total deduction of		$ 21,000
and would pay an excess profits tax on		$ 19,000

EXAMPLES—CORPORATION

Method of Computing Tax where Capital is Employed.

Assuming that a business has an invested capital for the taxable year of $300,000; that the net income subject to excess profits tax is $75,000; that the average income for the prewar years based on the average capital for the years 1911, 1912 and 1913 is 8 per cent., the tax would be computed as follows:

Net Income (25 % of invested capital)		$75,000.00
Deductions:		
8% of $300,000	$24,000.00	
Exemption	3,000.00	
Total Deductions		27,000.00
Balance subject to tax		$48,000.00

As follows: On amount not in excess of

15% of Capital	$45,000.00			
Less Deduction	27,000.00			
Not in excess of 15% of Capital,	18,000.00	@	20%	$3,600.00
15 to 20% " "	15,000.00	"	25%	3,750.00
20 " 25% " "	15,000.00	"	35%	5,250.00
Taxable Amount	$48,000.00			
Total Tax				$12,600.00

[1] If the average percentage is between 7 and 9 per cent. the exact rate should be used as the rate of deduction.

In a case where the amount of the deduction exceeds 15 per cent. of the invested capital the excess is creditable under the higher rates and the tax will be computed as follows:

Assuming that a corporation has an invested capital for the taxable year of $30,000; a net income for the taxable year of $12,000; and an average prewar profit of 9 per cent., the tax would be computed as follows:

Net Income. (40% of invested capital)				$12,000.00
Deductions:				
9% of $30,000			$2,700.00	
Exemption			3,000.00	
Total Deduction				5,700.00
Balance subject to tax				$ 6,300.00
As follows:				
Not in excess of 15% of Capital,	$4,500.00			
Less Deduction	5,700.00			
Balance	None	@ 20%	None	
15 to 20% of Capital	$1,500.00			
Less Deduction in excess of 15% of capital (5,700 less 4,500)	$1,200.00			
Balance	300.00	@ 25%	$ 75.00	
20 to 25% of Capital	1,500.00	" 35%	525.00	
25 " 33% " "	2,400.00	" 45%	1,080.00	
Over 33% " "	2,100.00	" 60%	1,260.00	
Taxable Amount	$6,300.00			
Total Tax				$ 2,940.00

Examples—Individuals and Partnerships

Assuming that an individual or partnership has an invested capital for the taxable year of $200,000; a net income subject to excess profits tax of $60,000; an average prewar income of 9 per cent., the tax would be computed as follows:

Net Income (30% of invested capital)			$60,000.00
Deduction:			
9% of $200,000		$18,000.00	
Exemption		6,000.00	
Total Deduction			24,000.00
Balance subject to tax			36,000.00
As follows:			
On amount not in excess of 15% of capital	$30,000.00		
Less Deduction	24,000.00		
Not in excess of 15% of Capital,	6,000.00 @ 20%	$1,200.00	
15 to 20% " "	10,000.00 " 25%	2,500.00	
20 " 25% " "	10,000.00 " 35%	3,500.00	
25 " 33% " "	10,000.00 " 45%	4,500.00	
Taxable Amount	$36,000.00		
Total Tax			$11,700.00

Where the amount of the deduction is greater than 15 per cent. of the invested capital and cannot all be allowed under the first rate (20 per cent.) the remaining portion may be deducted from the amount taxable under the second, third, fourth or fifth rate, as the case may require.

Assuming, for example, that an individual or partnership has an invested capital for the taxable year of $30,000; a net income for the taxable year of $12,000; an average prewar net income of 9 per cent., the tax will be computed as follows:

Net Income (40% of invested capital)			$12,000.00
Deduction:			
9% of $30,000		$2,700.00	
Exemption		6,000.00	
Total Deduction			$ 8,700.00
Balance subject to tax			$ 3,300.00
As follows:			
Not in excess of 15% of Capital, $4,500.00			
Less Deduction	8,700.00		
Balance	None @ 20%	None	

15 to 20% of Capital.....	$1,500.00			
Less, Deduction in excess of 15% of Capital (8,700 less 4,500).....	4,200.00			
Balance.....	None	@ 25%	..None	
20 to 25% of Capital.....	$1,500.00			
Less, Deduction in excess of 20% of Capital (8,700 less 6,000).....	2,700.00			
Balance.....	None	@ 35%	..None	
25 to 33% of Capital.....	$2,400.00			
Less, Deduction in excess of 25% of Capital (8,700 less 7,500)	1,200.00			
Balance.....	$1,200.00	@ 45%	$ 540.00	
In excess of 33% of Capital...	2,100.00	@ 60%	1,260.00	
Taxable Amount.....	$3,300.00			
Total Tax.....				$ 1,800.00

EXAMPLE—CORPORATIONS

Net Income.....	$50,000.00
Nominal Capital. Less Exemption.....	3,000.00
Subject to Tax.....	47,000.00
Tax @ 8%.....	$ 3,760.00

EXAMPLE—INDIVIDUALS AND PARTNERSHIPS

Net Income.....	$50,000.00
Less Exemption.....	6,000.00
Subject to Tax.....	44,000.00
Tax @ 8%.....	$ 3,520.00

Deductions to Foreign Corporations and Partnerships. Nonresident Aliens.

Foreign corporations, foreign partnerships and nonresident aliens are allowed the same deductions in lieu of normal or prewar profits as domestic corporations and partnerships, citizens and residents, but are not allowed any specific exemption of $6,000 or $3,000.

Corporation or Partnership not in Existence and Individual Not in Trade in Prewar Period.

If a corporation or partnership was not in existence or an individual was not engaged in the trade or business during the whole of any one calendar year of the prewar period, the deduction allowed shall be an amount equal to 8 per cent. of the invested capital for the taxable year, plus $3,000 in the case of domestic corporations and $6,000 in the case of domestic partnerships or citizens or residents of the United States. (Law, Section 204.)

Where Business Yielded no Net Income or Comparatively Low Net Income. Subnormal Profits.

Where a corporation, partnership or individual had no net income during the prewar period or where the percentage of income of the invested capital was low as compared with that of representative concerns in a like business, the corporation, partnership or individual may, upon complaint to the Secretary of the Treasury obtain a deduction of:

(1) An amount equal to the same percentage of its invested capital for the taxable year which the average deduction for such year of representative concerns in a similar business is of their average invested capital for such year,

plus

(2) $3,000 to corporations,
$6,000 to citizens or residents,
$6,000 to partnerships.

The percentage of the representative concerns, in this case, would be computed as prescribed on page 142, illustrated by example, except that for this purpose the specific exemption ($3,000 or $6,000) would not be deducted.

The effect of this provision is that those who were in business during the prewar years and had no profit or had a low percentage of profit may file a complaint with the Secretary of the Treasury and claim a deduction based on the average per-

centage of representative concerns in a like or similar business. As to what would be a low percentage of profit is a question for the complainant to determine from his knowledge of profits made in the same trade or business. It would seem reasonable, however, that any concern that made an average of less than 9 per cent. would have a right to file such complaint.

The percentage which the net income was of the invested capital in each trade or business can only be fixed by the Commissioner of Internal Revenue.

How to Obtain Benefit of Deduction Based on Income of Representative Concerns.

The law requires that returns must be made on the basis of the average percentage of profit of the respondent as outlined on page 142 (illustrated by example) and that the assessment be made thereon, but at the time of filing such return a claim for abatement should be filed of the amount by which the tax so assessed exceeds the tax computed on the basis of representative concerns. Inasmuch as the Department cannot compute the average percentage of net income of representative concerns until it has received the returns from which to make the computations, it will be necessary for those who complain, and file claims for abatement, to assume, for the purpose of deduction, the maximum percentage (9 per cent.) and to prepare a return on that basis, such return to accompany the claim for abatement.

Although the assessment is made on the basis of the return showing the actual percentage earned (subject to provision of law—7 to 9 per cent), it is provided that the amount of the claim for abatement shall not be paid until the claim is decided, except that if, in the judgment of the Commissioner of Internal Revenue the interests of the United States would be jeopardized by the delay, he may require the claimant to furnish a bond for the amount of the claim. Upon failure to furnish satisfactory surety within such time as the Commissioner may prescribe the full amount of the assessment will be collected at once, and, when the claim has been passed upon, the amount found to be due to the claimant, if any, will be refunded as a tax erroneously collected.

Undoubtedly, the Treasury Department will issue a special form of claim for abatement which will be obtainable from the Collectors of Internal Revenue.[1]

[1] If a special form is not provided Form 47 should be used.

The amount of tax payable before the claim for abatement is decided upon, will be the lesser amount as shown to be due according to the return in which the deduction is based upon the average income of representative concerns; in other words, the amount of the assessment, less the claim for abatement.

Salaries of Partners when Deductible.

A strict interpretation of the provisions of the Excess Profits Tax Law with reference to returns to be made by partnerships would indicate that in the matter of deductions, partnerships are entitled only to such deductions as are applicable to individuals.[1] That, also, seemed to be the opinion of Congress at the time the Act was under consideration and is confirmed by a statement by Senator Simmons, Chairman of the Finance Committee of the Senate, made just prior to the final vote and passage of the Act by the Senate in reply to a question by Senator Calder. The question was, "Why should individuals receive a larger exemption than corporations?" Senator Simmons stated, as one of the reasons, that corporations have the right to deduct salaries of officers and managers, whereas, individuals and partnerships have not that right. The following is an extract from the Senator's speech of October 2, 1917, as contained in the *Congressional Record* of October 16, 1917:

> The Senator also inquires why we make this differentiation in the exemptions in favor of individuals and partnerships. We did it for the reason that the corporation has the privilege, which it always exercises, of paying its officers and managers salaries and deducting from the earnings of the corporation the amounts so paid as a part of the expenses of the business. In the law as it is written the members of partnerships or individuals can not allow themselves compensation for their personal services, so that if the Senator and I were operating as a corporation we could pay ourselves a salary out of the earnings of that corporation and deduct it, giving in our income tax; but if we were operating as partners we would not be entitled under the law to pay ourselves salaries and have the amount deducted. Such a course would be inconsistent with the whole income tax scheme with reference to partnerships,

[1] A salary allowance is made to partnerships and individuals by T. D. 2611 (Dec. 20, 1917). See page 169.

because a partnership does not have to pay any income tax, as a corporation does. Under the law all of its earnings are regarded as distributed, whether actually distributed or not. Though they may be retained in the business, the law, when it goes to impose the income tax upon the partners regards the total earnings of the year as having come into their hands, and requires them to give in those earnings for taxation. The same is true with respect to the individual. The partner stands exactly in the position of the individual. Neither is permitted to allow himself a salary and deduct it, and if he were permitted to allow a salary for personal service, and deduct it in ascertaining his excess-profits tax, he would have to give the amount so allowed in for income tax, and the thing would be as broad as it is long."

Except for the last sentence of Senator Simmons' statement the prohibition upon the deductibility of salaries to partners, in his opinion, would be unmistakable. His concluding remark, however, that inasmuch as the partners receiving salaries must return them under the Excess Profits Tax Law would effect the same result and make it "as broad as it is long" lends a degree of favor to the view that such salaries are deductible.

Heretofore, under the Act of September 8, 1916, the Treasury Department has held that salaries paid to partners were subject to withholding at the source, thereby recognizing the deductibility of such payments. Under the Excess Profits Tax Law of March 3, 1917 (now repealed), it was ruled that salaries of partners, in certain cases, were deductible in determining the amount of assessment of partnerships. Likewise, it has been held under present law, according to a letter written by the Department under date of October 19, 1917, to Daniel B. Cahn, of New York, that stipulated salaries or drawings of partners, regularly paid or credited pursuant to the terms of a partnership agreement for services rendered, may be deducted by the partnership as an expense of doing business, provided such allowance, salary or drawings are not excessive in amount and not greater than would be paid by a corporation for similar services rendered by an officer or an employee.

The following is a copy of the letter to Mr. Cahn:

"Receipt is acknowledged of your letter of October 10, 1917, wherein you request to be advised whether or not a

salary paid by a domestic partnership to one of its individual members can be claimed as a deduction in computing the partnership's liability to tax under the provisions of the War Excess Profits Tax Law of October 3, 1917.

"In reply you are advised that in a case where, under the terms of a partnership agreement, an individual member of the firm is regularly paid, or is allowed to draw, or has placed to his individual credit, a certain stipulated amount, as compensation for services rendered, that amount may be deducted by the partnership as a business expense if it is not excessive in amount and is no greater than what would ordinarily be paid by a corporation or individual conducting a business of like character to an officer or employee who rendered services similar to those rendered by the partnership member."

The position taken by the Treasury Department on this question is, by far, the more equitable in effect, and one to which partnerships will take no exception. The law, strictly construed, however, would probably result in a conclusion adverse to partnerships, inequitable as it would seem.

In the absence of a reversal of the ruling quoted herein in favor of partnerships, they are permitted, under the circumstances mentioned, to deduct salaries of partners.[1]

The requirement that partnerships shall be limited in their deductions to those allowed to individuals creates, in some cases, an anomalous situation. For example, where a partnership of three members, employing a nominal capital, earns a net profit for the taxable year of $18,000, and there are no provisions for salaries or regular drawings, the partnership will pay an Excess Profits Tax of 8 per cent. on $18,000, less an exemption of $6,000, namely, $12,000, amounting to $960, equivalent to an assessment of each partner of $320. An individual, however, engaged on his own account, in the same line of work or business as the partnership, with the same amount of income as the individual partners, would receive the same amount of exemption as the partnership and would go untaxed. No doubt this problem will be dealt with in the next Session of Congress.

As an economic principle, labor, not required to be paid, does

[1] The allowance of salaries to partners has been affirmed by T. D. 2611 (Dec. 20, 1917). See page 169.

not diminish profits. But where a farmer employs the members of his family, whether or not he is entitled by law to the benefit of their labor, an equivalent deduction, for tax purposes, should be allowed. Representative Kitchin's opinion is otherwise according to his statement in the House of Representatives in reply to a question by Representative Reavis, as follows: (From *Congressional Record*, October 16, 1917).

Wages of Members of Farmer's Family not Deductible.

"MR. REAVIS. Let me suggest this condition, and it doubtless prevails in the gentleman's district as it does in mine: Take, for instance, the farmer who has a large family following the example of the gentleman, and who employs his boys upon the farm to aid him in his work. Is he entitled to a deduction for that labor, even though he does not pay for it?

"MR. KITCHIN. No.

"MR. REAVIS. Then he would be paying excess-profits taxes on the labor rather than on the real profits, would he not?

"MR. KITCHIN. Yes, to a certain extent, because in most States if the child is under 21 his labor belongs to the parent.

"MR. REAVIS. He is entitled to the labor?

"MR. KITCHIN. Yes.

"MR. REAVIS. That being true, he would pay a tax on the returns with no deductions for labor.

"MR. KITCHIN. And that is one reason why I personally and the House conferees were not in favor of including individuals in the excess-profits tax. The owner of practically all the stock of the corporation could charge up his own salary as officer of the corporation, and for the labor of his wife and children if they performed services for it, and deduct the amounts so paid or charged up as part of the operating expenses from the amount of taxable income or profits, while the individual in same kind of business with same capital and making same profits could not have any such deduction."

Inasmuch as partnerships and individuals, for purposes of the Excess Profits Tax, by T. D. 2611, may deduct reasonable salaries or compensation for personal services actually rendered in the conduct of business or trade, there is no doubt but that the farmer may deduct an equivalent for the services of himself and members of his family.

Unquestionably, the law will be fairly and equitably administered. To obtain an equitable administration, the law must be construed liberally and more by the "rule of reason" than by its literal interpretation. An old doctrine holds that a statute should be interpreted according to the intent of the legislators. In the case of an exceptional tax measure, however, such as that of the Excess Profits Tax, it would be unreasonable to expect that the intricacies of business and commercial practice could have been foreseen and anticipated. Moreover, to have contemplated the inherent difficulties and provided for details of administration would have required a tax volume, that, of necessity, would have been technical, cumbersome and unwieldy.

Administration of Law.

Application of Law to Real and Nominal Capital.

To what extent an application of the "rule of reason" will be justified must depend upon the facts of the particular case under consideration, and *must be determined with a view to the spirit of the law and the cause which actuated Congress to enact it.*

Not only is it important, in an equitable administration of the Act, to guard against excessive assessments, but it is equally as important to prevent under-assessments, that, by reason thereof, effect undue advantage either in individual or classes of cases. In so far as practicable particular industries should be taxed upon a uniform and consistent basis of assessment. For example, a case recently brought to the writer's notice: A mining property, yielding an annual net income of about $250,000, was inherited by three members of a family. For the purpose of establishing perpetuity of organization, a corporation was formed with a nominal capital stock of $10,000 and the property was conveyed to the corporation in exchange for the capital stock thereof. Such corporation could probably be construed to have "not more than a nominal capital." Adjoining the property in question is a mine of about the same size and yield as that of the close corporation's, but said property is owned by an operating company having an outstanding capital stock of one million dollars. To tax the close corporation on the basis of a nominal capital would impose upon it an excess profits tax of $19,760 upon an income of $250,000, whereas the corporation operating the adjoining property, on the same income, but with a capital of a million dollars, would be assessed, under the pro-

gressive rates, from $41,400 to $45,400. This inequality would give the close corporation an unwarranted advantage over the corporation with the larger capital stock. Admittedly, the close corporation has only a nominal capital stock, but the tangible property owned by it may be worth as much, or perhaps more, than the invested capital of its neighbor with the larger stock capitalization. Expediency, in cases of this kind, requires that where real capital (in contradistinction to nominal capital) is employed, the enterprise should be taxed upon the basis of "more than a nominal capital." The deduction, in such case, should be computed either upon the actual invested capital (if that is properly ascertainable) or the corporation should be allowed a deduction based upon that of representative concerns in a similar trade or business, as provided for in section 210 of the Act.

The same principles can be aptly applied to businesses that are not of an individualistic character. Where the average deductions of "representative" concerns are inapplicable, or where there are no representative concerns in a similar trade or business and where neither of the prescribed methods of computing the tax (8 per cent. or progressive rates) are clearly pertinent to the particular case, the taxpayer should apply to the Department for a special ruling upon such case. If a ruling is not obtainable in due time, the taxpayer should make a return upon the basis that appears, from a consideration of the requirements of law, and the facts of the case, to be the most relevant of the prescribed methods. The return should be accompanied by a complete and comprehensive statement of all material facts upon which the Department will be able to judge as to the propriety of the method employed.

The only provisions for revaluations of tangible property in connection with the ascertainment of invested capital under the Excess Profits Tax Law, are contained in sec- **Revaluation** tion 207 (a) with respect to corporations and part- **of Property.** nerships and 207 (b) as to individuals.

In the case of corporations and partnerships, tangible property received in exchange for stock or shares therein may be stated at the cash value, except that if the property was acquired prior to January 1, 1914, then at the cash value as of that date; in no case, however, can such value be stated in excess of the par value of the original stock or shares issued for the property.

Cash capital should be stated at the "actual cash paid in." Construing this literally, a deficit need not be deducted from capital paid in, for purposes of invested capital.

Paid in or earned surplus and undivided profits, except profits earned during the taxable year, also comprise invested capital under the law. The amount of surplus can best be ascertained for such purpose by preparing a statement of the assets and liabilities in which the assets (tangible and intangible) should be stated at values in respect of limitations of law. The excess of assets so valued, over the liabilities plus the capital stock, will comprise the surplus. (See Example No. 1, page 155.)

In the case of individuals, tangible property paid into a trade or business, other than cash, should be stated at the actual cash value of the property at the time of such payment, except that property paid in prior to January 1, 1914, should be stated at its cash value as of January 1, 1914. In connection with the latter provision, the value as at January 1, 1914, does not appear to be limited to the original value at which the property was paid in as in the case of corporations. On the other hand, there is no provision for the inclusion of earned surplus employed in the business of the individual. This omission will, no doubt, be ruled upon by the Treasury Department.

An equitable interpretation of the law will require that individuals shall be permitted to compute invested capital inclusive of accumulated earnings, and that construction may reasonably be within the purview of the provision "the actual cash value of tangible property paid into the trade or business. . . ." Capital is an ever changing quantity in a commercial business. Earnings that are allowed to remain invested in a business, increase its capital. There is no legal obligation on the part of an individual, conducting trade, to have any particular sum permanently invested as in the case of a corporation.

Tangible property paid in prior to January 1, 1914, may be stated at its value at that time, but that does not provide for profits earned and allowed to remain invested in the business since that date. The taxpayer should obtain a ruling upon this point from the Collector of his district.[1]

[1] Until a ruling has been made by the Department the writer suggests that the individual taxpayer include in invested capital all assets that are employed in the business, whether paid in or earned.

EXAMPLE NO. 1—COMPUTING INVESTED CAPITAL AS AT BEGINNING OF FISCAL YEAR

Item No.	Assets			Balance per Books of Account	Invested Capital
1	Cash in Office and in Banks			$ 15,200.00	$ 15,200.00
2	Accounts Receivable	$ 48,300.00			
	Reserve for Bad Debts [1]	$ 2,415.00			
	Reserve for cash discounts on sales [1]	1,200.00	3,615.00	44,685.00	
	Analysis of accounts:				
	Total	$48,300.00			
	Uncollectible	800.00			
	Good	47,500.00			47,500.00
3	Bills Receivable (Notes)			20,500.00	20,500.00
4	Inventory of Stock on Hand			152,000.00	152,000.00
5	Investments:				
	Liberty Bonds, 3½ s [2]		50,000.00		
	" " 4 s [2]		75,000.00		
				125,000.00	125,000.00
	25 shares of X. Y. Z. Co., Inc. (Common)		12,500.00		
	15 shares of X. Y. Z. Co., Inc. (Preferred)		15,000.00		
				27,500.00	
6	Plant and Machinery (Cost)		125,000.00		
	Written off in excess of Income Tax allowances	25,000.00			
	Depreciation deducted from Income Tax returns and allowed	25,000.00	50,000.00		
	Book Value		75,000.00	75,000.00	

[1] Not deducted from Income Tax Return.

[2] Liberty Loan Bonds cannot comprise invested capital until after April 24, 1917, or September 24, 1917, the dates that the first and second issues were respectively approved.

Cost		$125,000.00		
Depreciation allowed (Income Tax)		25,000.00		
Value (Invested Capital)		100,000.00		$100,000.00
7 Furniture and Fixtures (Cost)		4,500.00		
Written off in excess of Income Tax deductions	2,200.00			
Depreciation deducted from Income Tax returns	2,250.00	4,450.00		
Nominal Book Value			50.00	
Cost		4,500.00		
Depreciation deducted from Income Tax returns		2,250.00		
Value (Invested Capital)		2,250.00		2,250.00
8 Land:				
Acquired for Capital Stock (Par Value)		75,000.00		
Erroneously written off to effect agreement with local real estate assessment value		15,000.00		
Book value			60,000.00	
Cash value, January 1, 1914				75,000.00
9 Buildings:				
Acquired for Capital Stock (Par Value)		150,000.00		
Written off to Reserve for Depreciation in excess of Income Tax Allowances	20,000.00			
Depreciation deducted from				

	Income Tax returns and allowed.....	$25,000.00	$45,000.00	
	Book value.....		105,000.00	$105,000.00
	Cash value, Jan. 1, 1914.....		140,000.00	
	Depreciation deducted and allowed in Income Tax returns since Jan. 1, 1914.....		15,000.00	
	Value (Invested Capital)....		125,000.00	$125,000.00
10	Good Will (Acquired in exchange for Capital Stock prior to March 3, 1917).....		100,000.00	
	Written off to surplus.....		50,000.00	50,000.00
	Allowed as invested capital (not in excess of 20% of capital stock).....			80,000.00
11	Prepayments:			
	Prepaid Unexpired Insurance.....		675.00	
	Prepaid Interest.....		400.00	1,075.00	1,075.00
12	Aggregate Totals.....			$676,010.00	$743,525.00

Item No.	*Liabilities*		*Balance per Books of Account*	*Invested Capital Deductions*
13	Accounts Payable.....		$ 30,000.00	$ 30,000.00
14	Bills Payable (Notes).....		15,000.00	15,000.00
15	Accruals:			
	Accrued Taxes.....	$ 1,000.00		
	Accrued Interest.....	2,500.00		
			3,500.00	3,500.00
16	First Mortgage Bonds Payable.....		100,000.00	100.000,00
17	Dividend Declared on Preferred Stock (5%).		10,000.00	10,000.00
18	Total Liabilities.....		158,500.00	158,500.00
19	Reserve for Amortization of Bonds.....		25,000.00	
20	Reserve for Contingencies.....		10,000.00	
21	Reserve for Equalization of Dividends.....		20,000.00	

22 Capital Stock:			
Common	$200,000.00		
Preferred	200,000.00		
		$400,000.00	
23 Surplus		62,510.00	
Totals		676,010.00	$158,500.00
24 Invested Capital			585,025.00
25 Aggregate Totals		$676,010.00	$743,525.00

EXAMPLE NO. 2—ALTERNATIVE METHOD (NO. 1) OF COMPUTING INVESTED CAPITAL

Total Assets, as per books of account (Item 12)			$676,010.00
Total Liabilities, as per books of account (Item 18)			158,500.00
Assets in excess of Liabilities as per books of account			$517,510.00
Properties inadequately stated in Books of Account:		*Add*	
Accounts Receivable: (Item 2)			
Collectible Accounts	$ 47,500.00		
Balance, per books of account	44,685.00	$ 2,815.00	
Plant and Machinery: (Item 6)			
Value	100,000.00		
Balance, per books of account	75,000.00	25,000.00	
Furniture and Fixtures: (Item 7)			
Value	2,250.00		
Balance, per books of account	50.00	2,200.00	
Land: (Item 8)			
Cost (Cash Value Jan. 1, 1914)	75,000.00		
Balance, per books of account	60,000.00	15,000.00	
Buildings: (Item 9)			
Value	125,000.00		
Balance, per books of account	105,000.00	20,000.00	
Good Will: (Item 10)			
Allowed by law (20% of capital stock)	80,000.00		
Balance, per books of account	50,000.00	30,000.00	

Add		$95,015.00
Total		612,525.00
Disallowed for purposes of Invested Capital:	*Deduct*	
Securities excluded by law (Item 5)	$27,500.00	
Deduct		27,500.00
INVESTED CAPITAL (Item 24)		$585,025.00

EXAMPLE NO. 3—ALTERNATIVE METHOD (NO. 2) OF COMPUTING INVESTED CAPITAL

Capital Stock Outstanding (Item No. 22)	$400,000.00
Surplus, per books of account (Item 23)	62,510.00
Reserves:	
Amortization of Bonds (Item 19)	25,000.00
For Contingencies (Item 20)	10,000.00
For Equalization of Dividends (Item 21)	20,000.00
Additions to Invested Capital by reason of properties being inadequately stated in books of account (Items 2, 6, 7, 8, 9, and 10, per itemized list in Example No. 2)	95,015.00
Total	612,525.00
Deduct Securities excluded by law (Item 5)	27,500.00
INVESTED CAPITAL (Item 24)	$585,025.00

NOTES ON ITEMS CONTAINED IN EXAMPLE NO. 1, COMPUTING INVESTED CAPITAL (PAGE 155)

Item No. 1, Cash on Hand and in Banks.

The inclusion of cash on hand and in banks is conditioned upon the funds being used and employed in the business.

Item No. 2, Accounts Receivable.

Accounts receivable constitute invested capital at the total amount of accounts considered good. Any accounts that have been deducted from income tax returns, as uncollectible, shall not be included. Suspense accounts that are considered as realizable in whole or in part, and which have not been returned as bad debts for income tax purposes, may be included to such an amount as they are con-

sidered good and collectible. (A secret reserve decreases the invested capital and is detrimental to the interests of the taxpayer.)

A reserve for bad debts is not deductible from income for tax purposes, and, hence, need not be deducted in computing invested capital. The same is true of a reserve for cash discounts on sales.

Trade discounts, however, which are unconditional allowances may be reserved and deducted from income if they were not deducted from invoices rendered, but the amount thereof should, in such case, be deducted from accounts receivable in computing invested capital.

Notes receivable should be stated at the book value thereof.

Item No. 3, Bills Receivable. The qualifications in respect of bad debts, with regard to Item 2, are also applicable to bills receivable.

Treasury Department rulings prescribe that inventories shall

Item No. 4, Stock on Hand. be computed at cost.[1] The amount of inventory used in determining the profit or loss should also be used for purposes of invested capital.

Item No. 5, Investments. Liberty Bonds and all obligations of the United States constitute invested capital. (Law, section 207.)

Investments in stocks and bonds of other corporations or organizations, and other assets, the income from which is not subject to the Excess Profits Tax, do not constitute invested capital under the Act.

In the case at point, the plant and machinery cost $125,000. There had been written off, and deducted and allowed from in-

Item No. 6, Plant and Machinery. come tax returns, the sum of $25,000, and, in addition, a like sum had been written off but deduction of the same, for tax purposes, had been disallowed by the Department on the ground that the same was excessive. The actual value of the property is assumed to be $100,000. Said amount, representing the cost, less the depreciation allowed for tax purposes, is stated as available for purposes of invested capital.

The English practice, as stated by Mr. W. E. Snelling, in his work "Excess Profits Duty" (1916) is as follows:

[1] By authority of T. D. 2609 inventories may be valued at cost or market price whichever is lower.

"Plant and Machinery should appear in the capital computation at its total capitalised cost to date, less the aggregate of the Income Tax allowance to date."

Plant and machinery received in exchange for capital stock acquired prior to January 1, 1914, may be stated at the cash value as of that date, but such cash value shall not be in excess of the amount of stock, at par, paid therefor. If depreciation has been deducted thereon since that date the aggregate amount of same should be deducted in determining invested capital for the taxable year. Property acquired since January 1, 1914, may be valued at cost, less depreciation deducted thereon from income tax returns.

In the event that an excessive rate of depreciation has been deducted from returns of past years it may be permissible to file an amended return for such years with a lesser deduction. The amount shown to be due by the amended return, if accepted by the Department, will be taxable at the rate applicable to the year for which such amended return is made. Good and sufficient reasons must be furnished to the Department in order to effect an acceptance of the amended return. For rulings, in this connection, see page 195.

Any depreciation that was deducted from returns, and written off on the books of account, but which was not allowed by the Department, does not necessarily reduce the value for purposes of invested capital.

Depreciation that was deducted prior to the incidence of the Excise and Income Taxes may or may not reduce the value of property by the amount thereof. If depreciation was written off, such writing off is evidence of depreciation having been sustained. If, however, it becomes evident that excessive depreciation had been written off an error was made and there can be no valid reason why the error should not thereafter be remedied. But if such error was made since returns of income have been required, amended returns for the years affected should be filed and the additional tax paid.

Ordinarily, the difference between the cost of wasting property and depreciation charged off indicates the value for purposes of invested capital. Where, however, the book value has been arbitrarily written down for the purpose, for example,

of creating a secret reserve, by carrying the property at a nominal book value, if such deductions were not made from income tax returns the actual value may be reëstablished by providing only for the wear and tear sustained.

In placing values upon property for capital purposes the treatment of each case must necessarily depend upon the particular circumstances attending it. The earning power or productivity of property must be given due consideration as well as the sound or intrinsic value of such property.

Item No. 7, Furniture and Fixtures.

The total cost of the furniture and fixtures was $4,500. There had been arbitrarily charged off to Surplus the sum of $2,200, which had not been deducted from tax returns; depreciation had been charged off and deducted from income for tax purposes aggregating 50 per cent. of the total cost of the property, namely, $2,250; leaving a nominal book value of $50. For the purpose of the illustration it is assumed that the amount deducted from tax returns (50 per cent.) represents the actual wear and tear sustained and that the remaining 50 per cent. or $2,250 is the actual value of, and invested capital in the property for the taxable year. No cognizance need be taken of the amount arbitrarily charged off ($2,200) because the same does not represent wear and tear or actual loss sustained.

Item No. 8, Land.

It is assumed that the land was acquired in exchange for capital stock of the par value of $75,000. There had been erroneously charged off the sum of $15,000 to effect an agreement of the book account with the local real estate tax assessment. The object of showing the lesser value upon the books of account had been to be able to represent to the local tax assessors that $60,000 was the amount at which the land was carried in their books of account, and, also, to have their local tax return in agreement with their accounts. This reduction in the book value does not defeat the corporation of valuing the land at its cash value on January 1, 1914, as provided by section 207 (a) of the Excess Profits Tax Law.

Item No. 9, Buildings.

The buildings, as in the case of the land, were acquired in exchange for capital stock of the corporation at the par value of $150,000. There had been charged off and

deducted for tax purposes the sum of $20,000, but as the same had not been allowed by reason of being excessive, the same may be disregarded in determining invested capital. An aggregate sum of $25,000 had been deducted and allowed in tax returns; of this amount $15,000 had been deducted since January 1, 1914. The book value stood at $105,000. By authority of section 207 (a) of the law, the buildings were re-valued as at January 1, 1914, at their cash value, ascertained to be $140,000; deducting the depreciation of $15,000, sustained since January 1, 1914, leaves a value for invested capital of $125,000.

The good will had been acquired in exchange for capital stock at the par value of $100,000 prior to March 3, 1917, and pursuant to authority of law [section 207 (a) 3] is stated as invested capital at 20 per cent. of the capital stock, namely, $80,000. The fact that the corporation had written off 50 per cent. of the account against surplus does not deprive it of a full deduction of the 20 per cent. of the capital stock. The same would be true if the account had been completely written off, provided, of course, that the good will had not been disposed of by sale or otherwise and is used in the business. For a more complete discussion of "good will" and intangible property, see page 138.

Item No. 10, Good Will.

Prepaid expenses or deferred assets such as prepaid unexpired insurance and prepaid interest, constitute invested capital.

Item No. 11, Deferred Assets, Prepayments.

These represent, respectively, the total assets as they appear in the books of account and as they have been valued for purposes of invested capital.

Item No. 12, Aggregate Totals.

Item No. 13, Accounts Payable.

All of these items (No. 13 to No. 16, inclusive) being liabilities of the corporation, are a deduction from the aggregate total of assets in determining the surplus of the business, which, by provision of law constitutes invested capital.

Item No. 14, Bills Payable.

Item No. 15, Accrued Liabilities.

Item No. 16, Bonds Payable.

Item No. 17, Dividend Declared. A dividend becomes a liability as at the time of its declaration, and, as such, is a reduction of the surplus for purposes of invested capital.

Item No. 18, Total Liabilities. This item needs no explanation, except that the amount thereof, deducted from the totals of assets (Item 12) per books of account, and as computed for invested capital represent, respectively, the net worth as per the books of account and the capital and surplus comprising the invested capital, the latter being shown in Item 24.

Item No. 19, Reserve for Amortization of Bonds This reserve has been created by a charge to surplus account and a credit to the reserve. It was not deducted from income tax returns because the offset to it is not an expense. Hence, such a reserve is equivalent to surplus.

Item No. 20, Reserve for Contingencies. A reserve for contingencies may or may not be surplus. If, in its establishment, it was deducted from earnings or profits, as an expense or loss, and was deducted from income tax returns, it would not be surplus for purposes of invested capital. In the case at point, it was created by a charge to and reduction of surplus account and, therefore, is, itself, surplus.

Item No. 21, Reserve for Equalizing Dividends. Such a reserve always constitutes a part of surplus.

Item No. 22, Capital Stock. This item represents the paid in and outstanding capital stock of the corporation. As shown by Items 8, 9 and 10, respectively, stock was issued in exchange for:

Land	$ 75,000.00
Buildings	150,000.00
Good Will	100,000.00
Total	$325,000.00

The balance of $75,000 was issued for cash; and the total, $400,000, deducted from the excess of assets (Item 12) over the liabilities (Item 18) constitutes the surplus of the corporation.

This account represents the accumulated profits, except those that were established in the reserve accounts for specific purposes, which also constitute surplus. **Item No. 23, Surplus.**

This item is the excess of: **Item No. 24, Invested Capital.**

Item 12 (Assets)	$743,525.00
over " 18 (Liabilities)	158,500.00

and comprises the invested capital based on values for that purpose, of $585,025.00

The invested capital, in the example, is made up of:

Capital paid in	$400,000.00
Accumulated earnings	185,025.00
Total	$585,025.00

To the above amount should be added the monthly average of any additional capital paid in during the taxable year, but no part of the earnings of the taxable year may be added to the invested capital of such taxable year for purposes of deductions under the Excess Profits Tax.

Item No. 25, Aggregate Totals. These totals, respectively, agree with totals in Item 12.

Example No. 2 (Page 158)

This example presents a short alternative method of computing invested capital. It is based primarily upon the book account balances. To the excess of assets over liabilities, as shown by the books of account, are added all items that were increased by valuations placed thereon in accordance with "invested capital values," and reduced by the amount of item that is not recognized by law as a part of invested capital.

Example No. 3 (Page 159)

Example No. 3 shows another alternative method of computing invested capital. This method is predicated upon the capi-

tal stock plus surplus, as shown by the books of account, to which are added and subtracted the differences between the book values and values for purposes of invested capital.

Suggestions in Connection with the Valuation of Assets for Purposes of Invested Capital not Included in Example No. 1

Organization Expenses.

By rulings of the Treasury Department, organization expenses are not deductible from income; they are held to be capital expenditures. (See page 111). Although, from a commercial viewpoint, capitalized expenses are looked upon with disfavor, where such expenses have been paid by capital stock or out of moneys received from the original sale of stock, were set up as assets, and have not been charged off, it would seem proper to state them as invested capital to the amount actually so paid. Such items should only consist of the initial expenses incurred in connection with organizing a corporation; no additions should be made thereto after the organization has been completed.

Subscriptions to Capital Stock.

An unpaid subscription to capital stock, although an account receivable, is not such an asset as will constitute invested capital. It is not capital paid in, in any sense of that term, nor is it employed in the business.

Treasury Stock.

Treasury stock, in the usual acceptation of that term, denotes stock that has been fully paid for in cash or property and returned to the corporation. Inasmuch as invested capital is defined by the Act as actual cash paid in, the actual cash value of tangible property paid in other than cash, and intangible property bona fide paid for by cash or tangible property or by stock (with limitations) it must follow that treasury stock, fully paid for, constitutes invested capital. This conclusion is reached, not by reason of value attaching to the treasury stock as an asset of the corporation, but because it represents capital paid in. Stock repurchased by a corporation cannot be so treated because upon its reacquirement by purchase, it ceases to be paid in.

Unexecuted contracts purchased for cash, property, or stock,

may in some cases constitute invested capital, subject, however, to the limitations of law prescribed by section 207 as to intangible property. **Unexecuted Contracts.**

These items are dealt with on page 138. **Patents. Trade-marks. Franchise.**

Assets of this class constitute invested capital to the amount of cost thereof, less the amount charged off against income, provided that they are employed in the business. Unused patterns, designs, plates or dies that have been discarded and play no part in the production of profits should not be stated as invested capital, except, perhaps, at their residual value, if they have any. Assets of the same general character as those under discussion should be judged in respect of invested capital principally upon their productivity in the business, but always limited to the cost, less that part thereof which has been charged off. **Patterns and Designs. Plates and Dies.**

TREASURY DECISIONS UNDER THE EXCESS PROFITS TAX

Stock on hand of merchandise, supplies, and work in process of mercantile and manufacturing businesses, and of securities held by dealers, for purposes of income taxes and excess profits taxes, may be inventoried either: **Inventories of Merchandise, etc., and Securities held by Dealers.**

(a) at cost, or

(b) at cost or market price whichever is lower.

Whichever method is adopted must be adhered to in subsequent years unless a change in the method is authorized by the Commissioner of Internal Revenue.

This ruling is only applicable to commodities dealt in and not to subjects of more or less permanent investment. T. D. 2609.

Washington, D. C., December 19, 1917.

To Collectors of Internal Revenue, Revenue Agents, and Others Concerned:

1. For the purposes of income and excess profits tax returns, inventories of merchandise, etc., and of securities, will be subject to the following rules:

A. Inventories of supplies, raw materials, work in process of production and unsold merchandise, must be taken either

(a) at cost, or (b) at cost or market price whichever is lower; provided that the method adopted must be adhered to in subsequent years unless another be authorized by the Commissioner of Internal Revenue.

B. A dealer in securities who in his books of account regularly inventories unsold securities on hand either (a) at cost, or (b) at cost or market price whichever is lower, may for purposes of income and excess profits taxes make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years unless another be authorized by the Commissioner of Internal Revenue.

C. Gain or loss resulting from the sale or disposition of assets inventoried as above must be computed as the difference between the inventory value and the price or value at which sold or disposed of.

2. In all other cases inventories must be taken at cost or at value as of March 1, 1913, as the case may be.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

APPROVED:
W. G. MCADOO,
Secretary of the Treasury.

Tangible and Intangible Property Defined.

In many instances the construction placed by the Department upon the terms "tangible property" and "intangible property" will determine whether or not a particular asset constitutes invested capital. According to the following ruling (T. D. 2610) stocks, bonds, bills and accounts receivable and notes and other evidences of indebtedness are construed to be tangible property.

Washington, D. C., December 20, 1917.

To Collectors of Internal Revenue, Revenue Agents and Others Concerned:

The term "other intangible property" as used in section 207 will be construed to mean property of a character similar to good-will, trade-marks, and the other specific kinds of property enumerated in the same clause. With

respect to property not clearly of such a character rulings will be issued as occasion may demand to indicate whether it shall be regarded as tangible or intangible.

To date, the following classes of property have been construed to be tangible property within the meaning of section 207:

Stocks,
Bonds,
Bills and accounts receivable,
Notes and other evidences of indebtedness.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

APPROVED:
W. G. MCADOO,
Secretary of the Treasury.

It is not clear, to the writer, why stocks and bonds, by law excluded as invested capital, the income from which is not subject to the tax, should have been stated in the foregoing Treasury Decision, unless it refers to cases where securities are dealt in as a commodity, or where an original issue of capital stock is paid for by securities.

Salary Allowance to Partnerships and Individuals

It has been held by the Treasury Department that for the purpose of determining the amount of net income subject to the Excess Profits Tax where actual capital is employed, partnerships and individuals will be allowed to deduct a reasonable amount in lieu of a salary compensation, "not in excess of the salary or compensation customarily paid for similar service" in a like or similar trade or business. In the case of partnerships such deduction in lieu of salary compensation will be allowed whether or not a previous agreement therefor existed, but only to March 1, 1918. On and after that date such allowance, in the case of partnerships, will only be permitted where provision for the same is made by partnership agreement and where the salaries are actually paid to the partners.

In both cases (partnerships and individuals) the person credited with such salary allowance must make an individual return and pay the excess profits tax at the 8 per cent. rate. T. D. 2611.

Washington, D. C., December 20, 1917.

To Collectors of Internal Revenue, Revenue Agents and Others Concerned:

1. In computing net income for purposes of the Excess Profits Tax a partnership will be allowed to deduct as an expense reasonable salaries or compensation paid to individual partners for personal services actually rendered during the taxable year, if payments are made in accordance with prior agreements and are properly recorded on the books of the partnership. In no case shall the salaries or compensation so deducted be in excess of the salaries or compensation customarily paid for similar services under like responsibilities by corporations engaged in like or similar trades or businesses.

With respect to any period prior to March 1, 1918, where no previous agreement has been made as to salaries or compensation a similar deduction will be allowed for services actually rendered.

In the case of a foreign partnership the deduction shall be limited to those portions of salaries or compensation which are paid for services rendered with respect to trade or business carried on in the United States.

A partner in his individual capacity is, however, subject to the excess profits tax, if any, at the 8 per cent rate under section 209 with respect to any salary or compensation from the partnership for personal services (including any amounts allowed to the partnership as a deduction for the period prior to March 1, 1918).

2. An individual carrying on a trade or business having an invested capital may designate a reasonable amount as salary or compensation for personal service actually rendered by him in the conduct of such trade or business. In no case shall the amount so designated be in excess of the salaries or compensation customarily paid for similar service under like responsibilities by corporations or partnerships engaged in like or similar trades or businesses.

In the case of a non-resident alien individual, the amount shall be limited to that portion of the salary or compensation which is for service rendered with respect to trade or business carried on in the United States.

An individual is, however, subject to the excess profits tax, if any, at the 8 per cent rate under section 209 with respect to the amount so designated, and the balance of

the income derived from such trade or business shall be subject to the graduated rates prescribed in section 201.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

APPROVED:
W. G. MCADOO,
Secretary of the Treasury.

Profits derived by Partners from Partnerships.

By ruling of the Department (T. D. 2612) it has been held that a partner, with respect to his share in the profits of a partnership, is not subject to the Excess Profits Tax. As stated in T. D. 2611 (*ante*) he is, however, liable individually for such tax with respect to any salary compensation credited or paid to him.

Washington, D. C., December 20, 1917.

To Collectors of Internal Revenue, Revenue Agents and Others Concerned:

A partner in his individual capacity will not be considered as engaged in trade or business with respect to his share in the profits of the partnership, and consequently will not be subject to excess profits tax thereon. He is, however, subject to the excess profits tax, if any, at the 8 per cent. rate under section 209 with respect to any salary or compensation from the partnership for personal services (including any amounts allowed to the partnership as a deduction for the period prior to March 1, 1918).

DANIEL C. ROPER,
Commissioner of Internal Revenue.

APPROVED:
W. G. MCADOO,
Secretary of the Treasury.

Interest on Loans by Partners.

Interest paid by a partnership to a partner on a *bona fide* loan to such partnership may be deducted as a partnership expense. Interest upon capital is not deductible. T. D. 2613.

Washington, D. C., December 20, 1917.

To Collectors of Internal Revenue, Revenue Agents and Others Concerned:

In computing net income for the purpose of the excess profits tax a partnership will be allowed to deduct amounts

paid during the year to an individual partner as interest upon any *bona fide* loan, but no deduction for so-called interest upon capital will be recognized.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

APPROVED:
W. G. MCADOO,
Secretary of the Treasury.

Return Prewar Period.

Where an individual, partnership or corporation, engaged in business during the prewar period, is content to accept the minimum deduction of 7 per cent. upon invested capital for the taxable year, it is not necessary to file a return of net income or invested capital for the prewar years. A business or trade employing no capital or not more than a nominal capital, being taxed at the flat rate of 8 per cent. is not required to report income or invested capital for the prewar years. T. D. 2614.

Washington, D. C., December 20, 1917.

To Collectors of Internal Revenue, Revenue Agents and Others Concerned:

For the purposes of the excess profits tax, a return of information with respect to the invested capital and net income for the *pre-war period* will not be required of a corporation, partnership or individual in the following cases:

(1) If the taxpayer accepts the minimum percentage, viz., 7 per cent. as percentage to be used in computing the deduction under section 203; or

(2) If the trade or business is taxable only at the 8 per cent. rate under section 209.

The foregoing must not be construed as not requiring a return of information as to all facts which may be necessary for the ascertainment of the capital and income *for the taxable year* whenever such a return is required by the Commissioner of Internal Revenue.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

APPROVED:
W. G. MCADOO,
Secretary of the Treasury.

Invested Capital

No ruling has been made, as yet, upon the relationship of various classes of bonds payable to invested capital. By prohibition of law borrowed money does not constitute invested capital. Proceeds of sales of bonds, secured by mortgage upon corporate property, are borrowed money. But all bonds are not secured by mortgage; in many cases a debenture bond is nothing more than a preferred stock. Will such debentures be held to be invested capital, or will preferred stock having the ear-marks of debentures be classed as borrowed money and excluded as invested capital? A preferred stock, for example, that is redeemable at a definite time, is cumulative as to interest, and provides for preferences as to assets in the event of dissolution, in effect, is a debenture. Is such stock invested capital? In the absence of a ruling to the contrary the taxpayer may treat the same as invested capital. In the writer's opinion certain classes of bonds are equivalent to preferred capital stock, called by some other name, as, for example, "debentures." Special rulings should be obtained in connection therewith, from the Treasury Department based upon the facts of the particular case.

Bonds as Invested Capital.

Where the business of an individual or partnership is incorporated and the owner or owners receive in exchange for such business both stock and bonds, the bonds so issued do not represent, in any sense, borrowed money. The writer ventures to predict that under such circumstances, where the stockholders are also the bondholders, under certain conditions of acquirement, bonds will be held to be invested capital. If it should be so ruled, no expenses in connection with such bonds should be allowed as deductions from net income; the interest paid thereon, for example, will then be a distribution of profits and not an expense. From time to time, as occasion demands, rulings will be made upon facts submitted to the Department. If no ruling has been rendered, at the time of making inquiry of the collector, upon a case similar to that presented by the inquirer, application for a special ruling should be made upon the facts involved in such case.

Decided injustice will result unless, by regulation or new

legislation, provision is made for the inclusion of actual values of property as invested capital. How this can be accomplished under existing law without violating its expressed provisions is now engaging the minds of the Committee of Advisers at Washington. That regulations will be made whereby substantial justice may be obtained by those against whom a technical construction of the law would result in discrimination and inequality, may be assured. In order to obtain such substantial justice, however, it will be necessary, in many cases, to demand of the Department special rulings upon the peculiar facts involved. Beyond question, Congress did not contemplate penalizing conservative capitalization; the general tenor of the law indicates a purpose to distribute the burden fairly and equitably.

Limitation of Value of Property as at Jan. 1, 1914.

CHAPTER VI

DEPRECIATION

Depreciation is a deductible allowance in the ascertainment of net income for tax purposes. It should represent, as nearly as possible, the actual deterioration of such physical properties as are susceptible of wear and tear. Obsolescence is not now recognized as an element of loss in computing depreciation for tax purposes, but loss sustained on discarded machinery is deductible.

Depreciation Deductible from Income.

In a broad sense of the word depreciation means a reduction in value and may be applied to all kinds of property. As used in the income tax law, however, it is applicable only to tangible property, such as is subject to wear and tear and exhaustion. Hence, depreciation will be allowed as a deduction from revenue only on physical properties, such as buildings, fixtures, machinery, etc. All depreciation to be deductible must be actually charged off in the books of account in the period for which it is claimed.

There are several methods of computing rates of depreciation, the most common of which are:

Methods of Computing Depreciation.

1. By equal instalments.
2. On diminishing values.

The first method is ordinarily used where the property depreciated has no residual value, and the second one where the property has a residual value. Charging off equal instalments is most commonly employed with respect to all properties, whether they have a residual value or not, and only that method has as yet been suggested or approved by rulings of the Treasury Department or court decision in connection with deductions from income tax returns.

In a publication issued by the Federal Trade Commission recently, on the subject of "Fundamentals of a Cost System for Manufacturers," both methods are approved in the following language: "There are several methods of determining the amount of depreciation. One is to estimate the scrap value

and deduct this figure from the original cost. The difference is then divided by the estimated life of the machine in years, and the result is the annual depreciation on that machine. A modification of this method which is not quite as simple, but really affords no difficulty, is after ascertaining the amount to be charged off during the life of the machine, to determine a percentage which, when applied to the net book value of the machine, will leave only the scrap value of the machine on the books at the expiration of its estimated life.

"To illustrate: If the initial cost of a machine and equipment is $1,000 and the estimated scrap value is $200, with an estimated life of ten years, then $800 is the amount that must be charged into cost during that period, or $80 per year. To attain this result, by using the net value of the machine as a basis, a rate of 15 per cent. would be necessary, which would make the depreciation 15 per cent. on $1,000, or $150 the first year; 15 per cent. on $850, or $127.50 the second year, etc. The advantage of this method in the interest of normal costs is, that the decrease in depreciation charges is ordinarily offset by an increase in repairs."

Where reserves for depreciation are used in conjunction with the "Diminishing Value Method" the amount of the reserve set aside in past periods should be deducted from the asset account before the depreciation is computed thereon.

Reserve for Depreciation.

The most approved method of double entry bookkeeping favors the establishment of reserves for depreciation instead of reducing the balances of the asset account in the ledger. This is accomplished by journal entry, made either monthly or at the end of the fiscal period, just prior to closing the books of account, as follows:

Depreciation	$250.00	
To Reserve for Depreciation of Furniture and Fixtures		$250.00
Depreciation at 10% per annum on Furniture and Fixtures for the year 1916. (Book value—cost—$2,500.)		

The Depreciation Account is closed into Profit and Loss Account and the Reserve for Depreciation, a negative account,[1] remains open. In the Statement of Assets and Liabilities the

[1] A negative account is one that is neither an asset nor a liability; it qualifies an asset account, as, for example, Furniture and Fixtures.

Reserve for Depreciation is deducted from the asset account and extended at the net amount, as follows:

Furniture and Fixtures	$2,500.00	
Less Reserve for Depreciation (10%)	250.00	
		$2,250.00

Although not essential, it is advisable to keep a separate reserve account for each class of assets, as: Reserve for Depreciation of Furniture and Fixtures, Reserve for Depreciation of Machinery, Reserve for Depreciation of Buildings, etc. This separation renders more accessible the amount of deduction from the respective asset accounts, when preparing the balance sheet.

A Reserve for Depreciation must be kept separate and distinct from other reserve accounts and reserve funds. A reserve fund is an amount set aside for the purpose, among others, of providing an available asset (cash or readily convertible investment) for a present or future obligation, as a renewal of plant and machinery. The creation of such fund does not incur the reduction of surplus or profit because it is not an expense; it is not created by a reduction of revenue, but merely a conversion of profits or surplus. Hence, a reserve fund set aside for amortization of bonds, or to provide quick assets for any other purpose, is not a competent deduction in an income tax return. Nor are reserve accounts properly deductible except in so far as they are a reduction of the value of an asset. A reserve account appearing on the liability side of a balance sheet, unless represented by a specially invested fund in the assets, is offset by all the assets in the balance sheet. But a "Reserve for Depreciation" is, technically, neither a reserve fund nor reserve account, because it has been charged against revenue and has reduced the surplus. To be a true reserve it should not reduce the revenue or surplus. Therefore, a "Reserve for Depreciation" is nothing more than an "allowance for depreciation" and should never be stated on the liability side of a balance sheet. It is nothing more than a negative account, a reduction of the book value of a particular asset, and should be deducted in the Statement of Assets and Liabilities from the asset to which it refers.

Diverting Reserves.

Hence, under rulings in connection with the income tax, a

so-called "Reserve for Depreciation" should not be diverted to any purpose except "making good the loss sustained by reason of wear and tear, exhaustion * * * of the property with respect to which it was claimed."

Depreciation may only be charged off up to the cost of the property depreciated. Should depreciation, for any reason, have been charged off in excess of such amount, then such excess must be reported as income (Art. 132, Reg. 33).

Rates of Depreciation.

The law does not prescribe rates of depreciation because these depend upon the kind and class of property, and upon the conditions under which the property is used. Fixing rates of depreciation is more or less arbitrary at best.

The fairness of rates of depreciation, deducted in returns of net income, are questions of fact, and not of law; that is to say, such questions at issue in a court of law would, ordinarily, be submitted to a jury for determination.

Technical rate fixing is a question on which there are diversified opinions, even amongst the best engineers. But engineers have suggested rates for various classes of properties that work out fairly accurately for all practical purposes. The rates mentioned herein are suggestive only. They are based upon the experience of engineers and accountants.

Buildings.[1]

In the case of Hyman Cohen *v.* John Z. Lowe, Jr., Collector (234 Fed. 474), tried before a jury in the United States District Court for the Southern District of New York, Judge Grubb stated that, in his opinion, depreciation on a building should be based upon the number of years "the building would remain in a condition to be habitable for the uses for which it was constructed and used. . . . The annual depreciation would be an amount represented by a fraction having one (the tax year) for the numerator and the number of years, representing the ascertained life of the building, as the denominator." Hence, a building, estimated to remain habitable and fit for the purposes for which it was erected for a term of forty years, would suffer an annual depreciation of 2½ per

[1] The Department has stated (not by Treasury Decision) that it is estimated that the probable life of a frame building is 25 years; brick building, 35 years, stone, steel or concrete building, 50 to 100 years. A taxpayer, however, is not bound by these estimates.

cent. In the Cohen case, just cited, the plaintiff (owner of building) claimed a depreciation of 5 per cent. for the tax year (1913). The Collector of Internal Revenue allowed only 3 per cent., and the plaintiff brought an action to enforce his claim of 5 per cent. The jury brought in a verdict that they considered 3 per cent. an adequate allowance. The building in question was a New York apartment house.

Depreciation is allowed only on the cost of buildings and improvements, not on the land. For depreciation and other purposes, buildings and land should be carried in separate accounts in the ledger. If the separate cost of buildings, as apart from the land, is not ascertainable, then the separate value of improvements, as shown by the real estate tax assessments, may be used, or, the value of buildings and improvements may be estimated as at March 1, 1913, if then in existence, "provided that the value placed upon such buildings shall not be in excess of the cost of such buildings, less an amount measuring the depreciation which had previously been sustained." (T. D. 2137.)

To measure the fairness of the amount on which depreciation has been deducted on buildings, in returns of net income, Internal Revenue Inspectors have made comparison with the amount of fire insurance carried thereon. But that, for obvious reasons, is not a fair comparison.

The question of rate of depreciation must always be determined upon the conditions governing each particular case. The rate on brick buildings varies from 1½ to 5 per cent. per annum, according to construction and use to which buildings are put. A factory building, wherein manufacturing of heavy machinery is carried on, may suffer a larger depreciation than 5 per cent. per annum.

It is reasonable to assume that frame buildings are subject to a larger rate of depreciation than brick or concrete buildings, because of having a shorter period of usefulness. The rates on frame buildings will vary from 2½ to 7½ per cent., according to construction and uses, and may run higher in some cases.

In estimating the life of a building for the purpose of determining upon a rate of depreciation, it must be assumed that the property is maintained in proper repair. The cost of repairs and expenses of upkeep are deductible items in a return of net income.

Building Repairs.

Additions. Betterments.

Additions to buildings or any expenditure that constitutes an increase in the investment therein, such as permanent improvements and betterments, are not deductible.

Additions to Leased Property.

A person or corporation holding premises as lessee, for a term of years, requiring the tenant by terms of the lease to make all repairs and improvements, if any, has the right to deduct the improvements as well as repairs from his or its gross income. Such improvements should be prorated over the period of the lease. The repairs, however, may be deducted as current expenses.

Buildings Erected by Tenants.

The cost of buildings erected by tenants on leased ground, which, upon expiration of the lease, revert to the landlord, may be prorated over the period of the lease and deducted as an expense of doing business. The amount charged off (prorated) should be deducted in the return of net income of a corporation as rent paid.

Furniture and Fixtures.

Ordinarily business concerns capitalize amounts paid for furniture, fixtures and office equipment; that is to say, they establish a Furniture and Fixture Account in the ledger and charge purchases of that class of assets to such account. This class of property depreciates from 5 to 25 per cent. per annum; 10 per cent. is the usual charge where renewals are added to the account.

An uncommon practice is to charge off the entire cost of renewals of furniture and office equipment as a cost of doing business. This method, in the case of Mutual Benefit Life Insurance Company *v.* Herold (198 Fed. 199), was approved. It was there held that "Renewals of office furniture and equipment" were "expense of maintenance" deductible in the ascertainment of net income. As this decision deals only with "renewals" of such equipment it would not apply to the first cost.

Furniture, fixtures and office equipment should be carried in a separate ledger account from office supplies. Office equipment represents a fixed asset, whereas office supplies is an expense account.

Dwellings.

Depreciation on a dwelling (residence) occupied by the owner himself is not deductible; on dwellings that are held for investment, however, by both individuals

and corporations, a reasonable charge for depreciation is allowed.

"Reasonable allowance for the wear and tear of property arising from its use for rental purposes may be claimed as a deduction, but no claim for depreciation should be made on account of any amount of expense of restoring property or making good the exhaustion thereof for which a deduction is claimed elsewhere in the return." (Letter by Commissioner of Internal Revenue to the Corporation Trust Co., February 26, 1916.)

Depreciation on farm buildings, other than those occupied by the owner himself, may be deducted from income. (T. D. 2090.) **Farm Buildings.**

A reasonable allowance for depletion of mines, not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, will be allowed. **Depletion of Mines.** When the allowance authorized shall equal the capital originally invested or in case of purchase made prior to March 1, 1913, the fair market value as of that date, no further allowance for depletion shall be made.

Corporations operating mines (including oil or gas wells) upon a royalty basis only cannot claim depreciation because of the exhaustion of the deposit. (Art. 145, Reg. 33.) **Leased Mines on Royalty.**

In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow. As in the case of mines, when the allowance authorized for depletion shall equal the capital originally invested, or in case of purchase made prior to March 1, 1913, the fair market value as of that date, then no further allowance shall be made. **Depletion, Oil and Gas Wells.**

Corporations leasing oil or gas territory shall base their depletion deduction upon the cost of the lease, and not upon the estimated value, in place of the oil or gas. (Art. 144, Reg. 33.) **Leased Oil and Gas Territory.**

The rate of depreciation on timber lands should be such as

Timber Lands. to return to the owner, when the timber has been exhausted, the capital originally invested therein, except if the property was acquired prior to March 1, 1913, the fair market value as of that date.

Machinery.[1] There are so many different classes and kinds of machinery that it would be well-nigh impossible to fix a rate of depreciation that would uniformly apply to all classes. L. R. Dicksee, an English accountant of recognized ability, in his work on "Depreciation, Reserves and Reserve Funds," has suggested annual rates of depreciation on machinery, based on diminishing values, as follows:

General machinery	7½ to 10 per cent.
Special machinery	10 to 25 per cent.

To facilitate the computing of depreciation on a variety of classes of machinery, it is advantageous to classify them according to expected life, and then to compute the depreciation on each class accordingly.

The scrap or residual value of machinery should be taken into consideration in arriving at rates of depreciation.

Boilers, Engines. There is a diversity of opinion as to the rate of depreciation to which engines and boilers are subject. Dicksee suggests annual rates, on a diminishing value, as follows:

Engines (in general)	10 to 12½ per cent.
Boilers	12½ to 20 per cent.

George M. Craven, whose tables of depreciation have been adopted by commissions passing upon rate cases, and who errs on the conservative rather than the liberal side, based on cost (not diminishing value) per annum, suggests the following rates:

Steam engines	3 to 6.6 per cent.
Boilers	3.5 to 10 per cent.

Composite opinions, however, are that engines and boilers, if maintained in a proper state of repair, which necessarily must be assumed, should last, in the absence of unfavorable conditions, about ten years, and would be subject to an average depreciation

[1] The Internal Revenue Bureau has stated (not by Treasury Decision) that "the estimated lifetime of ordinary machinery is ten years." The taxpayer is not bound by this estimate.

of 10 per cent. per annum. If unfavorable conditions prevail, they would naturally be replaced oftener and the rate of depreciation would be proportionately higher.

Article 131 of Treasury Department Regulations No. 33 states that "Incidental repairs which neither add to the value of the property nor appreciably prolong its life, but keep it in an operating condition, may be deducted as expenses." Notwithstanding the apparent clearness of this regulation, there have been many controversies between Collectors of Internal Revenue and taxpayers as to what constitutes "incidental repairs." Rulings on the subject have recommended the establishment of reserves for depreciation and directed that to such reserve accounts should be charged "the cost of renewing or replacing the property with respect to which the depreciation is claimed." But it is not intended that "incidental repairs" that merely "keep it in operating condition" shall be so charged, because, under the above regulation, such expenses are separately deductible from income.

Repairs.

Replacements.

The main object and purpose of charging off depreciation is not to provide a fund out of which to make repairs, but in the case of a machine, for example, to provide for the replacement of such machine when it has served its usefulness.

The income tax law contemplates more than a mere renewal and repair reserve because it specifically permits the deduction of "All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties . . . ," as well as "a reasonable allowance for the exhaustion, wear and tear of property arising out of its employment in the business or trade." These are separate and distinct provisions, first for necessary expenses, which must include repairs, and, second, for depreciation.

It may be true in respect to a machine, or any other property, which is periodically wholly rebuilt, that the depreciation is very small, but that it suffers some degree of depreciation is axiomatic. Whether, however, the cost of such renewals should be charged to the reserve for depreciation or to an expense account, should depend upon the adequacy of the rate of depreciation charged off. Hence, in fixing upon rates of depreciation it should be predetermined whether renewals will be

charged against the reserve for depreciation or to an expense account. Regardless of which method is adopted the accumulation of depreciation reserved should be such an amount as will equal the cost of the property upon the termination of its usefulness.

Shafting. Shafting, based upon a diminishing value, has been estimated to suffer depreciation at the rate of 5 to 7½ per cent. per annum.

Tools. Small tools should be charged to a separate account in the ledger. Physical inventories should be taken periodically and the account written down to the amount of such inventory. The difference between the book value and the physical inventory value should be charged to depreciation, and in the course of time it should be possible to determine upon an average rate of depreciation that will answer all practical purposes. Such average rate should, however, from time to time, be verified by physical inventories. This principle may be applied to all items that are being constantly used up and replaced.

Miscellaneous Equipment. Inasmuch as the rates of depreciation suggested by Craven have been adopted by various industrial concerns and commissions, they are worthy of consideration. They are, however, by many, considered too low and are stated here only as suggestive of the most conservative annual rates:

Shop Equipment	3 to 15	per cent.
Motors	4 to 10	per cent.
Storage Batteries	5 to 11	per cent.
Belted Generators	3.3 to 10	per cent.
Switchboards, etc	2 to 10	per cent.
Wires and Cables	2 to 6.6	per cent.
Steam Piping	3.5 to 10	per cent.
Steam Turbines	5 to 9	per cent.
Auxiliaries	5 to 10	per cent.

Laundry Equipment. The equipment of laundries is, ordinarily, subject to an annual depreciation of from 7½ to 15 per cent. of the cost.

Patterns are made of so large a variety of materials and used so differently, that each case will have to be decided according to the particular requirements. Patterns that are con-

tinuously used and must be replaced often may properly be charged off at once as a cost of production. Special patterns should always be charged direct to the job for which they were made. **Patterns.**

Dicksee suggests annual rates, based on diminishing values, of 25 to $33^1/_3$ per cent.

But there can be no obligation on the part of the manufacturer to capitalize any expenditure unless it is unquestionably a capital expense.

Accountancy maintains (some accountants to the contrary notwithstanding) that where there is a reasonable doubt as to whether an expenditure is a capital or expense item, it should be charged against revenue. That precludes questionable items entering a balance sheet, and indicates a business policy with which no law should be at variance.

Patents are issued in the United States for a period of seventeen years. It is customary for manufacturing corporations, operating under patent rights, to capitalize all direct expenses in connection with obtaining patents either by their own application to the Patent Office or by purchase. **Patents.**

In case the corporation itself procures the patent, it has the right to deduct depreciation annually at the rate of 1/17 of the total cost, including experimental work, cost of models and drawings, fees of the Patent Office, legal expenses, and all direct charges in connection therewith.

If the patent is purchased by the corporation, then the depreciation would be based on the cost thereof and the rate would be fixed according to the length of time that the patent had still to run; for instance, a patent purchased for $10,000, that had been issued seven years prior to its purchase, having a remaining life of ten years, would be subject to an annual depreciation of 10 per cent. of the cost, amounting to $1,000. This amount would be a competent annual charge against gross income.

The principles stated with respect to patents are true also as to copyrights, except that copyrights are issued for the period of twenty-eight years. A more conservative method, in the case of copyrights, however, is to estimate the period of salability of the subject of copyright and prorate the amount to be charged off accordingly. **Copyrights.**

Automobile trucks deteriorate according to the severity of the use to which they are subjected. The life of a motor, used for trucking purposes, receiving reasonable care and properly maintained, may be estimated to be from three to six years. As with other property, the rate of depreciation is fixed according to its life. The life of an auto truck is such a length of time as it remains fit for the purpose for which it was acquired.[1]

Auto Trucks.[1]

The annual rate applicable to auto trucks will vary from 15 to 50 per cent. Based on a replacement value, the heaviest depreciation occurs during the first year, and it is not uncommon to write off as much as 50 per cent. of the cost during that time. Thereafter the rate would not exceed 25 per cent. per annum.

The most accurate and conservative method is to appraise motor trucks at the end of each year and to write off the shrinkage in value during the year for which the return of net income is computed. This method, being based on actual facts, cannot be objectionable for income tax purposes.

All costs of repairs, replacements or parts, tires, overhauling, painting, supplies, gas, oil, licenses and insurance, in connection with auto trucks are deductible expenses in the return of net income.

Depreciation on horses varies so widely that each concern should work out its own table of experience for depreciation purposes. Rather than to guess at an arbitrary rate of depreciation, it is advisable to revalue horses at the end of each fiscal period. The loss in value during the tax year may then be deducted as depreciation, and, in the course of time, it will be possible to formulate, fairly accurately, the rate of depreciation to which horses, in the particular business, are subject. It may be said that, ordinarily, the rate of depreciation on horses will vary from 15 to 25 per cent. of their cost.

Horses.

Stable Equipment.

Stable equipment usually suffers a depreciation of from 7½ to 15 per cent. per annum.

Depreciation of good will is not allowed, because it is an

[1] The Internal Revenue Bureau has stated that it is estimated that the life of automobiles used for business or farm purposes and farm tractors is four to five years. Taxpayers are not bound by this estimate.

intangible asset that cannot suffer loss by reason of "wear and tear." From an accounting point of view, the practice of "writing down" the book value of good will is not an unusual one in periods of prosperity. Its purpose is, primarily, to reduce the book assets to tangible properties and thereby give the balance sheet a healthier appearance. The practice, although commendable, and perhaps a sign of conservative management, does not permit of a deduction in the income tax return. As a matter of bookkeeping, such a charge would be a reduction of Surplus Account and not of Profit and Loss Account for any particular period of time. **Good Will.**

No rule for charging off good will can be laid down, because in a flourishing business, the good will is of proportionate value and should not, in theory, be reduced; whereas, in periods when no profits are being earned, the value of good will diminishes, but then there is no profit out of which to reduce the Good Will Account. Hence, at best, the reduction of good will is a purely arbitrary matter that bears no relation to an income tax return.[1]

Stocks and bonds fluctuate in value. A downward fluctuation, if permanent, may be said to be depreciation, but such is not deductible for income tax purposes.[2] Losses to become deductible must be actually sustained by completed and closed transactions. A mere reduction in book value by direction of a board of directors, or even an order by the State or Federal Banking Department, to reduce or write off securities, does not establish a loss that constitutes a deduction from taxable income. "Losses of this character are only ascertainable when the securities mature, are disposed of, or canceled." (T. D. 2152.) **Investments.** **Stocks and Bonds.**

No arbitrary reduction of capital assets on the books of a corporation or individual shall justify a deduction from income for tax purposes. Conversely, the appreciating or "writing up," of capital assets to conform, for instance, with appraisal values, does not make such increase taxable as income. (Baldwin Locomotive Works *v.* McCoach, 221 Fed. 59.) There must be an actual realization of the enhanced value by a sale for

[1] As to valuation of good will for invested capital, see p. 138.

[2] A dealer in securities may inventory the same at cost or at cost or market price, whichever is the lower. (T. D. 2609.)

cash, or its equivalent, in order to make the increase taxable as income.

Theatrical Costumes. Theatrical costumes may be depreciated. The rate should be based on the life of garment or time allowed for production of play, whichever is the shorter. Wearing apparel, serving both the purpose of personal and theatrical use, may not be depreciated for the purpose of income tax.

Trade-marks. Brands. Neither trade-marks nor brands, acquired by purchase or otherwise, are subject to depreciation, and no allowance for income tax purposes will be made thereon.

In the case of resale of trademarks or brands, a loss actually sustained would be deductible, as a capital loss. A profit, on the other hand, would be returnable as income.

If the trade-mark or brand was acquired prior to March 1, 1913, then the profit or loss in the sale thereof would be computed on the basis of the fair market value as of that date and not on the basis of cost. This applies to the sale of all capital assets acquired prior to the incidence of the income tax law, March 1, 1913.

The cost of registering trade-marks and brands, being nominal, should be included in the expense of doing business. Should such an item be capitalized it would not be deductible as an expense in a subsequent year.

By rulings of the Treasury Department no allowance for depreciation is permitted on inventories of stock on hand.[1]

Stock on Hand. It has been held "that depreciation will not be allowed in the return or inventory, on merchandise, as the same will be reflected in the income in the year of its disposal." Also, as directed in the supplementary statement of the return, "In case the annual gain or loss is determined by inventory, merchandise must be inventoried at the cost price . . ." This is based upon the theory that no actual loss is sustained until the goods are sold.

These rulings are contrary to the well-settled principles of accounting, that when the market value of merchandise is less than the cost, the market value should prevail for inventory purposes.

[1] By more recent ruling (T. D. 2609, Dec. 19, 1917) inventories may now be computed at cost or at cost or market price, whichever is the lower. See page 167.

A merchant who commits an error of judgment in buying merchandise should be permitted to apportion his loss over the periods during which he is obliged to carry the unsalable goods in stock. In some lines of business the ruling will work a hardship. Publishers, for example, who must carry slow selling stock from year to year, a large part of which eventually proves unsalable, will be piling up inflated and exaggerated inventories of stock on hand, if computed at cost. No law should encourage the overstatement of values of assets because such overstatement affects the rights of creditors who rely on the representations of financial statements as a credit basis. Besides, under State laws, the overstatement of assets is punishable as a mispresentation of facts. Nor is the ruling that inventories must be computed at cost consistent with conservative business methods.

It is noteworthy that the Federal Trade Commission in a pamphlet issued on July 15th, 1916, entitled "A System of Accounts for Retail Merchants" for the purpose of "Aiding retail merchants to improve their accounting methods" on the subject of depreciation, states: "No merchant can be said to be managing his business properly unless adequate provision is made for depreciation." As to depreciation on merchandise, under the title of "Profit and Loss Account" it says: "A physical inventory should be taken at least once a year. The basis should be cost with conservative deduction for obsolete and shelf-worn goods." A perusal of the proforma Profit and Loss Account, contained on page 18 of the pamphlet, discloses a deduction from inventory designated "Less Stock Depreciation" of an amount equal to 5 per cent. of the inventory which concededly was based on cost.

The only danger that the depreciation of inventories would involve in connection with income tax returns, is the possible manipulation of merchandise values. As in the case of depreciation of capital assets, fixed rates could not be prescribed to cover all cases, but manipulation of inventories for the purpose of showing a smaller gross income than was actually earned could be prevented by requiring detailed information as to how the inventory was computed, rate of depreciation deducted, etc.

Until there has been a court adjudication upon the prescribed

ruling of computing inventories, stock on hand should be valued at cost. In cases where the inventory, taken at cost, results in an inflated or overstated "net income," it is recommended that the individual or company aggrieved place all the facts of his or its case in writing before the Commissioner of Internal Revenue, Washington, D. C., or the collector of his or its district, and ask for a special ruling thereon.[1]

Munitions Works, War Materials.

Many machine shops and factories engaged in manufacturing various classes of war materials have, during recent months, increased their capital and enlarged their plants for the purpose of extending their output. Some of these concerns have not only borrowed capital but have reinvested their current profits in additions and improvements without regard to their forthcoming obligations to the Government by reason of war income and excess profits taxes and without serious consideration of the questionable usefulness of their additions and improvements at the close of the present exceptional activities. This is a matter of which the Government might well take due notice with the view of fairly compensating those who have committed themselves by obligations, the payment of which, in some cases, will leave them with but an over extended plant for which there may be little or no future need.

In Great Britain liberal provision has been made by Regulations under the Munitions of War Acts for extra allowances for depreciation, the return of capital expenditures incurred particularly for munitions purposes, increased salaries of management, and other important matters.

The following are copies of Regulations issued under the Munitions of War Acts of Great Britain, as contained in "Excess Profits Duty" by Mr. W. E. Snelling (London, 1916):

> In determining the net profits for any period of assessment, due consideration shall be given to, and any appropriate adjustments may be made in respect of all or any of the following matters, that is to say—
>
> (a) Exceptional wear and tear of plant, buildings and machinery;
>
> (b) Capital expenditure specially incurred for the purpose of munitions work;

[1] See new ruling on this subject, page 167.

(c) The probable value to the controlled owner at the end of the period of control of any plant, buildings or machinery erected or installed or other expenditure incurred for munitions work, since the 4th of August, 1914;

(d) Special provisions or terms of any contracts entered into between the Government and the controlled owner;

(e) Any exceptional services rendered by the controlled owner in connection with the controlled establishment;

(f) Any increase in salaries or other emoluments of any persons engaged in the management or direction of the controlled establishment made since the end of the standard period, or any steps taken since the end of that period which might operate to decrease net profits;

(g) Generally any other matter which may appear to the Minister, or to the Referee, as the case may be, material to be taken into account.

Any such adjustments may be made either by additions to or deductions from the standard amount of profits or by way of charges or disallowance of charges against profits for the period of assessment. (Regulation 9.)

In ascertaining or determining net profits for the final period of assessment proper adjustments may be made in respect of the whole period of control in regard to any matters referred to in Rule 9, so far as it may then be shown that sufficient adjustments have not been made in regard thereto in ascertaining or determining net profits for any previous period or periods of assessment. (Regulation 12.)

The question of exceptional wear and tear of machinery and plant sustained by reason of operating them, double or treble the regular working time, is one upon which special rulings should be obtained from the Commissioner of Internal Revenue, Washington, D. C.

It seems only reasonable, also, that the Government should devise some means of amortizing the capital invested in undertakings where the plants, especially constructed to meet immediate needs, will have served their usefulness at the close of the present demands for them. These are matters about which the Commissioner of Internal Revenue should be addressed direct, and the suggestion is made with confidence that such requests will receive the consideration they merit.

As already indicated, rulings hold that rates of depreciation should be computed upon the estimated life of property. It is a question whether that method, applied to all classes of property, is based upon sound reasoning. In the case of ships, for example, the rate would, more accurately, be computed upon the estimated period of service than upon the duration of life.

Ships.

Rates of depreciation of ships range from 3 to 10 per cent., according to construction.

The English practice, as stated by Mr. William Sanders [1] is as follows:

"Allowances in respect of ships have, however, been *prima facie* fixed as follows by the Revenue:

"Steamers 4 per cent. on prime cost.

"Sailing ships 3 per cent. on prime cost."

He defines the prime cost as follows:

"Prime cost is the original cost price, plus subsequent capital expenditure, and the allowance is not to exceed the total prime cost less the breaking up value of 4 per cent. for steamers and 3 per cent. for sailing vessels."

Quoting, also, from a specific case [2] mentioned by Mr. Sanders:

> "The Commissioners, however, arrived at twenty-eight years as being the duration of life of a passenger steamer, and allowed 6 per cent. depreciation on the diminishing value."

Mr. Sanders' work [3] on the English Income Tax contains a very comprehensive table of rates of depreciation, applicable to various industries, which rates have been granted by the District Commissioners in the districts mentioned, as follows:

[1] "The Practice and Law of Income Tax and Super Tax" (1916).

[2] P. and O. Steam Navigation Co. *v.* Leslie (1900), C. A. (82 L. T. 137; 4 Tax. Cas. 177).

[3] "The Practice and Law of Income Tax and Super Tax" (1916) by William Sanders.

Nature of industry and district	*Rate per cent. of allowance*	*Remarks*
Boot trade—Leicester	7½	On full value
Brewers—Cardiff	5	On written-down value
Collieries—Cardiff	5	On written-down value
Coal exporting plant—		
Cardiff	5	On written-down value
Dyers and trimmers—		
Leicester	7½	On full value
do	10	If justified on inquiry
Engineers—Leicester	7½	On full value
Cardiff	5	On written-down value
Hosiery—Leicester	7½	On full value and higher rate if justified on inquiry
Nottingham	5	On fixed machinery
Lace making—Nottingham	5	On full value
do	7½	On written-down value
Looms and spinning machines—		
Huddersfield	5	On motive plant
do	7½	On spinning, dyeing, carding, and finishing machinery
Oldham	5	On engines, boilers and gearing
do	7½	On spinning machines
Newspaper and printing—		
Dundee	10	On printing machinery running double shifts
Glasgow	6	On ruling and book-binding machines
do	6	On type, linotype machines, etc.
do	7½	To include renewal of type not charged to Revenue
Nottingham	8½	On written-down value
Cardiff	5	On written-down value
Cardiff	7½	On written-down value for newspaper printing machines
do	15	On type

Nature of industry and district	*Rate per cent. of allowance*	*Remarks*
Sewing machines—Glasgow	10	On machines used in clothing factories.
Nottingham	10	Replacements all charged to capital.
Ship repairing and shipbuilding plant—Cardiff	5	On written-down value
Spinning machinery and woolcombs—Bradford	7½	On written-down value when machinery running day and night. Allowance reduced when heavy amount charged for repairs and renewals
Tramways—Glasgow	4½	Average over all per cent.
		Ducts 3
		Cables 3
		Poles and rosettes 2
		Section boxes 3
		Telephones 5
		Depot fittings 2
		Electric power plant 5
		Sub-stations plant 5
		Car works machinery 7½
		Permanent way plant 7½
		Rolling stock 5
		Punches 7½
		Furniture 5
Weaving—Bradford	5	On looms
Blackburn	5	On fixed boilers, engines, and fixed machinery
do	7½	On loose machinery, etc.
Huddersfield	7½	On spinning, weaving, carding, finishing and condensing machinery
do	5	On motive plant, shafting, etc.

"On full value" would, ordinarily, be equivalent to the cost.

"On written-down value" refers to the diminishing value. (See page 175.)

Like all rates of depreciation stated herein, those contained in the foregoing table are suggestive only. They are particularly valuable, however, in that they are drawn from actual Income Tax experience.

Adjusting Excess Depreciation.

Where it is found that an excessive rate of depreciation was deducted in past years, amended returns may be filed for such years and the additional tax will be assessed without penalty.

> "This office is in receipt of your letter of the 8th instant, in which you state that a corporation in its returns for the years 1911, 1912 and 1913 claimed depreciation of 12½% on the value of its machinery; that in 1917 an income tax inspector examined the books and recommended that depreciation at the rate of 5% be allowed and as a result, additional taxes were assessed against the corporation for the years 1911, 1912 and 1913, based upon the increase in net income resulting from the reduction of depreciation from 12½ to 5%; and that another corporation engaged in the same line of business and using the same kind of machinery charged off 12½% for depreciation on the same, but the books of this corporation were never examined and you ask what penalty, if any, the latter company will be required to pay for the years 1911, 1912 and 1913 if it now makes a claim that its calculations for such years were based on an excessive rate of depreciation.
>
> In reply, you are informed that no penalty will attach to the corporation if it files amended returns reducing its depreciation deduction from 12½ to 5% on its machinery. The amended returns should be prepared and filed with the Collector of Internal Revenue for its district with a letter of transmittal, stating the reason the amended returns were filed. The Collector will then notify this office and an additional tax of 1% will be assessed against the corporation due to the increase in its net income on account of the reduction of its depreciation deduction from 12½ to 5%." (Extract from letter to the First National Bank, Cleveland, Ohio, by Deputy Commissioner L. F. Speer, dated Nov. 16, 1917, published in the Income Tax Service of the Corporation Trust Co.)

CHAPTER VII

BOOKKEEPING SUGGESTIONS

Preparation of Income Tax Returns of Corporations

Methods of Bookkeeping.

The amended law contains a provision in regard to the keeping of accounts, as follows:

> "A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned."

The same provision is made with respect to the accounts of individuals.

This permits the individual or corporation, that employs a method of bookkeeping from which a return cannot be prepared in the prescribed form, to render the report according to the method of bookkeeping employed, provided only that the books from which the return is made reflect the correct income. The return, however, must, in every case, be made on the blank provided by the Government, with full and complete explanations as to the method employed.

The dominant and foremost requisite in the preparation of income tax returns is To Report the Facts. The method employed to arrive at the facts is of considerable importance, but secondary. A variance from the prescribed classification of income and expenses may be unavoidable; a deliberate disregard of the facts, by either omission or declaration, is tantamount to misrepresentation.

The income and expenses should be classified as prescribed

by the return unless the nature of the business is such that it does not permit of such classification or unless the books of account are kept in conformity with regulations of some department of the Government requiring the keeping of books according to "uniform systems of accounting," as in the case of corporations coming under the Interstate Commerce Commission.

The books must be so kept that each and every item set forth in the return of annual net income may be readily verified by an examination of the books of account.

"The books of a corporation are assumed to reflect the facts as to its earnings, income, etc. Hence they will be taken as the best guide in determining the net income upon which the tax imposed by this act is calculated. Except as the same may be modified by the provisions of the law, wherein certain deductions are limited, the net income disclosed by the books and verified by the annual balance sheet, or the annual report to stockholders, should be the same as that returned for taxation." (Regulations 33, Article 183.)

Books of Account Best Guide to Income.

"For the purpose of verifying any return, made pursuant to this act, the Commissioner of Internal Revenue may, by any duly authorized revenue agent or deputy collector, cause the books of such corporation to be examined, and if such examination discloses that the corporation is liable to tax in addition to that previously assessed, or assessable, the same shall be assessed and shall be payable immediately upon notice and demand. For the purpose of such examination, the books of corporations shall be open to the examining officer, or shall be produced for this purpose upon summons issued by any properly authorized officer." (Regulations 33, Article 186.)

Examination of Books by Internal Revenue Officers.

Although there has been no ruling upon specific methods of accounting under the present income tax law, it is clear that corporations or individuals keeping accounts upon the plan of accruing income and expenses or deferring prepayments, may prepare their returns accordingly. From an accounting viewpoint this is the only correct method whereby the true profit or loss of

Accruals.

Prepayments.

a business may be deduced. But the method, if employed, must be used consistently and with limitation. In no case shall an expense account for a tax year or fiscal year be charged with a greater amount than is actually incurred or accrued therein and for which the business has received value in such fiscal or tax year; that is to say, no deduction shall be made of an amount in excess of that actually chargeable against the operations of the year (fiscal or calendar) for which the return is made. Prepayments may be deferred, that is, such part of expenses as are prepaid may be deducted from expenses and treated as "deferred assets" or "prepayments" in the balance sheet.

The accounts most commonly accrued or deferred are interest, taxes, insurance, rents, salaries, commissions and income taxes withheld, but the principle is applicable to all classes of income and expenses.

No accruals shall be deducted from income unless they appear upon the books of account and represent expenses actually incurred or accrued during the year.

Wherever the expressions "actually paid" or "paid during the year" appear herein, when applied to individuals or corporations keeping their accounts upon the "accrual basis," such accruals are comprehended therein.

Apart from facilitating the preparation of income tax returns, bookkeeping suggestions would be out of place here.

Distribution of Accounts. But a great deal of time and work may be saved to the bookkeeper and to the executive who is responsible for the contents of the report, by employing a method of bookkeeping that will, without analysis of accounts, present to immediate view in a trial balance, the component parts called for by the income tax return. This can be accomplished only by a suitable distribution of accounts of income and expenses, assets and liabilities.

Merchandise sales should be credited to a separate account in the ledger. Where departmental accounts are kept, the

Sales. ledger should contain a separate sales account for each department or each class of commodity. The sales called for by the supplementary statement of the income tax return under "Gross Income from Operations" should be

the net sales, i. e., gross sales (amounts charged to customers) less returns, allowances and discounts allowed on sales.

Goods returned by customers should be charged to a separate account unless they are, in aggregate, so small a proportion of the sales that a separate account would not be justified. If no separate account is kept, the returns should be charged to Sales Account. The advantage of a separation—which bears no relation to the preparation of a tax report—is that a monthly trial balance discloses, at a glance, the proportion of returns to the volume of sales. **Return Sales.**

As stated under "Sales," goods returned by customers should, for the income tax report, be deducted from amount shown by Sales Account (Gross Sales).

Ordinary allowances on goods sold, such as claims by reason of breakage, short shipment, overcharges, defective goods, etc., should be charged to an Allowance Account and deducted from sales for the income tax return. Exceptional allowances, such as unrecovered shipments lost in transit, for which the shipper is responsible and cannot recover from the transportation company, should be charged to an account that by its title is descriptive of its contents, as "Goods Lost in Transit," and should be so stated in the income tax return. All losses, to be deductible from the income tax return, must be charged off in the year the loss is sustained. **Allowances.**

"Discounts allowed" on sales should be charged to an account bearing that title. "Discounts received" on goods purchased should be credited to a separate account so entitled. For income tax purposes discounts allowed to customers are a reduction of the gross sales, and discounts received, as a trade allowance or for prepayment of goods purchased, are a reduction of the cost of goods bought. **Discounts Allowed.** **Discounts Received.**

Rebates on sales that are allowed by way of commissions, or as a reward for selling certain quantities of commodities, should be carried in a separate account in the ledger and treated in the income tax return as a general expense under "Deductions" and included in "Commissions" in the supplementary statement under "General Expenses." **Rebates.**

Merchandise purchased should be charged to a "Purchase

Account" in the ledger. As an income tax deduction in the ascertainment of "Gross Income from Operations," there should be added to the purchases all transportation charges paid or incurred thereon. There should be deducted: returns, claims, discounts received and "anticipations" received.

Purchases.

A manufacturing corporation employing a cost system that is an integral part of the bookkeeping system, i. e., where such system is comprehended in the general books of account and included in the general ledger trial balance, may state as "Purchases" the cost of manufactured goods, as derived from such cost system. Mere cost memoranda, data, or books of account, however, that are not subject to proof of correctness, are not sufficiently reliable records from which to prepare income tax returns. It is not necessary that the cost accounts should be kept in the same binder or within the same cover as the general ledger, but, in summary, the costs should be controlled by general ledger accounts. For further discussion of this subject, see "Manufacturing Corporations Operating Cost-systems," page 216.

Where a cost-system does not answer the requirements of proof as to accuracy of results the form of return (Form 1031, Revised) should be adhered to. Corporations doing a mercantile business (buying and selling raw materials or finished products, manufactured by others) as well as a manufacturing business, should conform to the classification contained in the return, unless the separate departments are clearly differentiated in the books of account.

Transportation charges on goods sold (freight out) should be kept separate from those on goods purchased (freight in). Freight on goods sold, for income tax purposes, is an expense of doing business and should be included in "General Expenses." Transportation charges on goods bought increases their cost and should be added to the cost of purchases. Separate accounts in the ledger should be kept of freight on sales and freight on purchases, to be known, respectively, as "Freight Out" and "Freight In." Items of expressage and cartage may respectively be charged or credited to these accounts. In case where own trucks are used

Freight on Sales.

Freight on Purchases.

the apportionment may be estimated based upon the cost of stable or auto expenses, etc.

Stock on hand should be carried in a separate account in the ledger under the title of "Inventory Account." Where freight and other transportation charges have been added to the purchases, the proportion added thereto should, technically, be included in the inventory. But this would have to be approximated at best, and may, as an expediency, be disregarded except where it is a material item or where the computation is rendered simple. **Inventories.**

For income tax purposes, inventories should be computed at cost and so stated in the supplementary statement of the return.[1] The deduction of depreciation from the cost of commodities dealt in is prohibited. (See "Stock on Hand," page 188.) "No part of the overhead expenses should be added to the inventory."

Care should be exercised to see that the amount of stock on hand reported at the beginning of a tax year is the same amount as that shown as on hand at the close of the preceding year. An increase in the amount at the beginning of a year over that stated at the close of the previous year would result in a decrease in the gross income, which, in the absence of a clerical or technical error, might be *prima facie* evidence of fraud.

Rents received should be kept in a separate account from rents paid. Receipts of rent, where the corporation owns the rented property, must be reported as income, whereas rents paid are deductible as general expenses. The amount paid on a leasehold may be prorated over the period of the lease and deducted annually as rent paid during the year. This is also true where a building, reverting to the landlord, is erected on leased land; the annual rate of deduction being the fraction: one, as the numerator, and the number of years of the leasehold, as the denominator, multiplied by the cost of the building and improvements. The cost of such improvements should be charged to a "Leasehold Account" in the ledger and the amount charged off annually should be stated in the income tax return under "Expenses, General" in the supplementary statement. **Rentals.**

Ordinary rentals paid should also be stated in the supple-

[1] By more recent ruling inventories may now be computed at cost or at cost or market price, whichever is the lower. See page 167.

mentary statement under "Expenses, General" the total of which appears in the report under "Deductions."

Royalties received are returnable as income from rentals. Where royalties are both paid and received, it is advisable to keep a separate account for each in the ledger, designating them "Royalties Received" and "Royalties Paid," because they are separately reported in the return of net income. Royalties paid are returnable in "Payments in Lieu of Rent." Royalties received should be included in item "From Rentals" under "Gross Income."

Royalties.

Interest received and interest paid should be respectively credited and charged to separate ledger accounts, and each of them should be further subdivided according to the separation called for by the tax return, as follows:

Interest Received.

Interest received on bonds or other obligations of the United States, or its possessions, from a State, Municipality or other political subdivision, although not subject to the income tax, must be reported as income in the supplementary statement and should be credited to an account in the ledger entitled "Interest Received on Government Securities."

All interest, other than that received on Government bonds or obligations, except "anticipations," should be credited to a general "Interest Received Account," and should be reported under "Gross Income" in the return.

"Anticipations"—interest received for the prepayment of accounts payable—should be credited to "Anticipation Account" and for income tax purposes are deductible from the cost of purchases, the same as are discounts received.

Interest Paid.

Interest paid by a corporation should be classified as follows:

1. "Interest paid on indebtedness, wholly secured by collateral, the subject of sale in the ordinary business of the corporation," should be charged to an account entitled "Interest Paid on Secured Debts" and reported in the return under "Expenses, General," in the supplementary statement thereof.

2. Interest paid on mortgages secured by property which the corporation occupies but does not own and has no equity in, should be charged to "Interest Paid in Lieu of Rent" and stated in the return under "Deductions."

3. All interest paid on bonds and other indebtedness should be charged to "Interest Paid Account" and stated in the return under "Deductions." The amount of interest deductible under this item is the amount actually paid within the year on an amount of bonded or other indebtedness not in excess of the sum of one of the subdivisions of "A" plus "B":

A. 1. The paid-up capital stock outstanding at the close of the year,

or

2. If the capital stock has no par or nominal value, the amount of cash or its equivalent paid or transferred to the corporation as a consideration for shares issued and outstanding at the close of the year,

or

3. If no capital stock, the entire amount of capital (not including liabilities) employed in the business at the close of the year,

plus

B. One-half of the interest-bearing indebtedness outstanding at the close of the year.

For example, in the case of a corporation having, at the close of the year, a capital stock of $500,000 and bonded and other indebtedness of $200,000, the deductible interest, at 6 per cent. per annum, would not exceed:

6 per cent. on $500,000	$30,000
6 per cent. on 100,000	6,000
Total, 6 per cent. of $600,000	$36,000

Should the actual interest paid during the year exceed the sum of $36,000, in the example cited, the excess would not be deductible and only $36,000 should be entered in the report under "Deductions."

In the case of subdivision A, 3, having no capital stock, the "capital employed in the business . . . contemplates the entire capital paid in by the members of the company, including so much of the accumulated surplus as is not in excess of the needs of the business, but does not include any borrowed capital or interest-bearing indebtedness."

In the supplementary statement under "Interest Deductible" should be listed "all forms of indebtedness upon which interest was paid," stating as to each:

1. Name or kind of obligation (Bonds Payable, Mortgages Payable, Bills Payable, etc.),
2. Amount of principal of each class,
3. Rate of interest on each class,
4. Amount of interest paid on each class of obligations.

Irrespective of the amount deducted in the main report under "Deductions," the amount stated as "interest paid" in the supplementary statement is the total amount paid during the year. The amount deducted cannot exceed the total amount actually paid, but, by the limitation of law hereinbefore stated, may be less.

Interest paid on indebtedness incurred for the purchase of obligations or securities, the interest upon which is exempt from taxation is not deductible.[1]

The interest paid on indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of a corporation, as where a dealer in the property constituting such collateral or in the case of a broker loaning the funds thereby procured, may be deducted as a part of the expense of doing business, but such interest shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral.

No dividends or so-called interest on any kind of capital stock are deductible; "guaranteed," cumulative or preferred dividends are no exceptions.

Interest. Interest on any bonds of a corporation secured by mortgage on its real or personal property is deductible in a return of net income of the corporation.

"Debenture Bonds." Where, however, a corporation issues so-called "debenture bonds" secured by mortgages on real estate made by borrowers from the corporation in favor of such corporation, the interest on such bonds is not deductible from the taxable income. In the case of Middlesex Banking Company *v.* Robert O. Eaton, Collector (221 Fed. 86), affirmed by the United States Circuit Court of Appeals,

[1] An exception to this rule is the Second Liberty Loan Bonds, see p. 103.

it was found upon the trial that the plaintiff, under its charter had the powers of a safe-deposit company, of a bank of deposit, and of a company to sell securities, but that its principal business was the sale of securities. Judge Ward of the United States Circuit Court of Appeals found that "practically the whole of the business done by the plaintiff during the years in question was the sale of its own obligations, called 'debenture bonds,' secured by mortgages on property in the South and West, deposited with the Columbia Trust Co. as trustee for the bondholders, and of the obligations of borrowers to the plaintiff, secured by mortgages, which, accompanied by its own interest coupons for a less rate of interest than it receives from the borrowers, it guarantees as to both principal and interest and sells to purchasers. These latter are called 'guaranteed real estate securities.' Both these forms of securities the plaintiff sells throughout the East by means of agents, and its profit in each case is represented by the difference between the rate of interest it receives from its southern and western borrowers and the interest which it pays to the eastern purchasers of the obligations."

The plaintiff's theory was that the interest in question was paid upon money deposited with it and as such was deductible; this the Court disposed of in the following language: "Without stopping to analyze the charter powers of the plaintiff and to determine whether it is or is not a bank or banking association and, whether, if so, it has not also other and different powers, we think it perfectly clear that the interest in question is not interest upon money deposited with it, but is interest paid on its own obligations or on the obligations of others guaranteed by it which it has sold to the investing public. The purchase price is no more money deposited with the plaintiff at interest than is money paid to a railroad company for the purchase of its bonds. The transaction is not a banking transaction at all like the giving of a pass book or a certificate of deposit to a depositor, but a business of selling securities to investors. Selden *v.* Equitable Trust Co. (94 U. S. 419)."

F. A. Cleveland, in his work on *Funds and Their Uses* says that: "The term debenture bond is the most loosely used of any of the terms descriptive or suggestive of financial instru-

ments." The test of deductibility of interest on such bonds is whether it is actually an "expense of the business," and to be such it must be paid upon an actual obligation of the company, not merely upon an "evidence of indebtedness." Interest paid as a distribution of profits is not deductible in an income tax return.

Dividends Received. Dividends received by a corporation should be credited to "Dividends Received" account and the amount thereof should be reported in "Gross Income."

Inasmuch as dividends received by corporations upon the stock of other corporations, also subject to income taxes are, under the amended law, liable only for the normal tax of 2 per cent. under the Act of September 8, 1916, and free of taxes under the War Income Tax and the Excess Profits Tax, provision will be made in the revised return of corporations for a separate deduction of dividends.

Stock dividends constitute taxable income to the amount of the earnings or profits so distributed.

It is not necessary that the dividends be actually paid either by cash or stock, because "dividends shall be held to mean any distribution made or ordered to be made by a corporation out of its earnings." Therefore, a mere credit on the books of the issuing corporation is sufficient to obligate the recipient to include the amount of such credit applicable to him or it (a corporation) as income in his or its return of net income.

Income. Sundry Sources. All income, other than that derived from trading, rentals, interest, dividends received, and income from the sale of capital assets, should be credited in the ledger to an account "Income from Sundry Sources" and should be included in "Gross Income." Profits from the sale of capital assets should be included in this item of the return. For treatment of the account in the ledger, and method of computing profit from the sale of capital assets, see page 33.

In the supplementary statement, all income from sources other than those specifically called for in the return, which is subject to tax, should be itemized.

These items are called for *in toto* in the supplementary statement of the report, under "Expenses, General." "Labor" and

"wages" for the purpose of the income tax return, apply to all wages, direct and indirect (except where a cost-system is operated, see page 216). All salaries, other than those of officers of the corporation which are stated separately should be included in "Labor, Wages and Commissions." Bonus and profit sharing payments to employees other than officers, which are not gratuities, but additional pay for services actually rendered, should be included in this deduction. A separate ledger account should be kept to which items of this class will be charged.

Labor, Wages and Commissions.

Separate ledger accounts should be kept for wages and commissions, respectively, and each of them should be further subdivided into separate accounts according to requirements of the business. For example, wages paid in connection with production (Productive Wages), office salaries, salaries of salesmen, etc., should be carried in separate accounts to facilitate the preparation of intelligible Profit and Loss Accounts and for purposes of comparison of various departmental expenses of different periods.

Commissions, also, should be kept in accounts, that, by their title, designate whether they are applicable to cost of production, administration or selling expenses.

Income from commissions should be credited to a "Commissions Received" account and included in item "Gross Income" of the tax return. Where commissions are both received and paid they should be credited and charged, respectively, to separate ledger accounts that by their title are descriptive of their contents.

These items, called for in the supplementary statement, under "Expenses, General," should contain *in toto* only the cost of supplies and service purchased, such as coal, gas, electricity, power, etc., and should not include labor of engineers, firemen, etc., which latter are called for in "Wages."

Fuel, Light, Power, etc.

For the purpose of the income tax return, it is necessary only to keep one general "Repair Account" of materials. For accounting purposes, however, repairs should be subdivided according to requirements, as Repairs to Machinery and Plant, Repairs to Buildings, etc.

Repairs, Ordinary and Incidental.

To more easily prepare the tax report these accounts again should be divided into Repairs—Materials and Supplies, and Repairs—Wages, because they are called for separately. The separation of wages and materials only applies where the repairs are made by own employees of the corporation. Where the repairs are made by "outsiders" the total cost of repairs should be included in "Repairs."

Care should be exercised to differentiate repairs and renewals from improvements and betterments; the latter are not deductible as expenses. A mere replacement that is not an improvement and does not enhance the material value of property is chargeable as a repair; the same is true of that which merely maintains efficiency.

A separate ledger account, to which should be charged all salaries of officers, should be kept. The amount of such salaries will be stated in the supplementary statement of the return under "Expenses, General." A salary is, in the ordinary acceptation of the word, a compensation that is fixed by agreement in advance. Salaries, to be deductible, shall not be based upon stockholdings; they must be a business expense and not a distribution of profits. A distribution of profits is not deductible as an expense.

Salaries of Officers.

Where, however, "special payments, often designated as bonuses, are made to officers or employees of corporations, pursuant to a contract, express or implied, as additional compensation for services rendered, which payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered, such payments may be regarded as a part of the wages or hire of the officer or employee, and, as such, may allowably be deducted from gross income as a business expense." In such case the bonus or additional compensation of an officer should be included in item "Salaries of Officers." But "this ruling contemplates that such payments are conditioned upon the services rendered by the employee and not upon the earnings of the corporation. If it should appear that the additional or special payments are dependent upon the earnings of the company, rather than upon the services rendered, or if such payments are made only occasionally, and then, at the option of the corporation, as a sort of thank-offering

because of a prosperous year, and not in pursuance of a fixed policy or practice, or any contract, express or implied, it will be held that such payments are gratuities and, as such, are not properly deductible from gross income."

Voluntary contributions or donations, such as "Christmas gifts" are not deductible. But a payment by an employer to his employee, irrespective of when made, during the holiday or any other season of the year, in consideration of services rendered, as extra compensation, is deductible by the payer.

Sundry Expense Accounts.

In addition to the accounts, the balances of which are separately called for by the return, every mercantile concern has more or less additional expenses for which separate accounts, according to requirements, should be kept, such as:

Freight on Sales	Insurance
Packing Supplies	Postage
Shipping Supplies	Stationery & Printing
Stable Expense	Telegraph & Telephone
Auto Expense	Legal Expense
Advertising	Auditing Expense
Traveling Expense	General Office Expense

In the case of a manufacturing company, that does not operate a cost-system as an integral part of the bookkeeping system (see page 216) an intelligible classification would require such additional accounts as General Factory Expense, Production Supplies, etc.

All expenses that are not separately provided for in the return, such as those just mentioned, should be stated in item "Other Expenditures" in the supplementary statement. It is not necessary to state each account separately; they may be combined so as to include them all in five groups. Each group should contain items related to each other or coming under the same general head of production, administration or selling expenses. For example, they may be grouped as follows:

Packing and Shipping Supplies,
Stable and Auto Expense,
Advertising and Traveling Expense,
Postage, Stationery, Telegraph & Telephone,
Legal and Auditing Expense.

Items that cannot be classified under a general head may be stated as "Miscellaneous Unclassified Expenses," but the amount so stated should be comparatively small.

Customs Duties.

Import duties and import taxes should be charged to "Duties Account" in the ledger and included in the return as expense under "General Expense." These items should not be stated as taxes.

Loss by Fire.

Fire losses usually involve both capital and current assets. It is customary immediately after a fire casualty to proceed to arrive at an inventory based on cost of the destroyed, partly destroyed and damaged merchandise for insurance purposes. When this has been done the value of the destroyed and damaged merchandise, based on such inventory, should be charged to an account in the ledger bearing title of "Fire Loss Account." To this account should also be charged all expenses incurred in the adjustment of loss, including compensation of adjusters, if any, as well as the cost of repairs and replacement of buildings occasioned by the fire. The amount recovered from insurance companies should be credited to said account. The debit excess of the Fire Loss Account will then represent the loss sustained by fire which should be included in the income tax return in item "Losses Sustained," and under the same designation in the supplementary statement. At the end of the fiscal period the balance of Fire Loss Account should be charged to Profit and Loss Account.

Sales of Capital Assets.

The profit or loss on the sales of capital assets is determined in the case of assets acquired subsequent to March 1, 1913, by the difference between the cost and selling price. If the assets sold were acquired prior to March 1, 1913, then the profit or loss is the difference between the fair market value on March 1, 1913, and the selling price.

The profit or loss on the sale of capital assets should be credited or charged, respectively, to "Income on Sales of Capital Assets Account" and "Loss on Sales of Capital Assets." The debit of such accounts will be a transfer of the cost or fair market value, as the case may be, from the asset account in which the subject of sale had previously been carried in the ledger.

According to the supplementary statement of the income tax return, it would appear that the profit on sales of capital assets should be included in "Gross Income From Operations." This is obviously wrong in principle, and it is suggested that such income be stated in item "From other sources." Losses on sales of capital assets should be included in "Losses Sustained."

This subject has been treated at some length in Chapter VI, pages 175 to 195. Suffice it to say here, that any amount deducted in the return of net income for depreciation (in both the report and supplementary statement) must be actually charged off in the ledger, either on the asset account itself or in a negative account, such as, a Reserve for Depreciation. **Depreciation.**

Depreciation is usually charged off by a journal entry, debiting Depreciation Account and crediting Reserve for Depreciation. The Depreciation Account is closed into the Profit and Loss Account and the Reserve Account remains open until the asset that it offsets (writes down), is either sold or otherwise disposed of; then the difference between the cost and the amount written off in past years, plus proceeds of sale, is charged off as a capital loss or profit, as the case may be.

As in the case of depreciation of property, depletion of mines and oil or gas wells, by reason of exhaustion of the natural product, must be actually charged off in the ledger of the corporation seeking the deduction. Mere memorandum entries thereof are insufficient. The purpose of an allowance for depletion is to return to the corporation the capital invested, or, in case of purchase prior to March 1, 1913, an amount sufficient to return to the corporation the fair market value of such deposits as at that date. **Depletion.**

It has been indicated by the Commissioner of Internal Revenue that in order to render a claim for depletion of property deductible from income for tax purposes, it is insufficient to make a mere journal entry thereof; it must be actually charged off in the general ledger, either against the asset account of the property depleted, or to the credit of "Reserve for Depletion"; further, that such reserve shall be deducted from the asset account in **Ledger Entry of Depletion of Property.**

the balance sheet, as well as in the report to the stockholders. The amount deducted for depletion in an income tax return must, in fact, be charged off in such way that it reduces the asset account in the general ledger by the amount deducted in the return of annual net income.

Taxes.

Taxes should be charged to an account in the ledger bearing that title. All taxes are deductible except that:

1. Income and excess profits taxes are not deductible. (Excess profits tax assessment is deductible as a credit in ascertaining amount subject to income and war income taxes.)
2. Foreign taxes accruing to a foreign corporation are not deductible from income derived upon capital invested in this country.
3. Taxes paid for local benefits are not deductible.
4. Taxes paid by corporations to render their stock or bonds tax-free are not deductible, because such taxes are primarily obligations of their stockholders and bondholders.

Foreign taxes paid by a corporation organized under the laws of any State of the United States are deductible, because such corporation pays an income tax on its entire net income irrespective of where such income is derived or where its capital is invested.

Capital Stock.

The income tax return calls for the amount of capital stock paid in and outstanding. This does not include either stock unissued or "treasury stock." If the corporation has no capital stock, then it should state the amount of capital employed in the business, which, ordinarily, is the excess of the assets over liabilities, i. e., invested capital plus surplus.

The supplementary statement calls for the division of capital stock into common and preferred. If the company has no capital stock then the "capital employed in the business" should be stated. (See Interpretation, page 203.)

Uncollectible accounts receivable should be charged to a separate account that by its title designates what it contains,

such as Bad Debts, Uncollectible Accounts or Bad Accounts.

Bad Debts. Bad debts should not be charged to Profit and Loss Account until at the end of the fiscal period, when the books are closed.

Rulings direct that accounts shall be deducted only when they have been actually ascertained to be worthless. Reserves to provide for anticipated bad debts are not deductible. The accounts deducted must be charged off in the books of account during the year for which the return is made, wherein the accounts are deducted.

Payments received on accounts after they have been charged off should be credited to Income from Bad Debts Account and stated in the return as income "From other Sources" under "Gross Income."

The most prevalent causes that justify charging off accounts receivable, are:

1. Bankruptcy of debtor.
2. Assignment by debtor for benefit of creditors.
3. Execution against property returned unsatisfied.
4. Disappearance of debtor leaving no assets.
5. Death of debtor leaving no estate.

The test of charging off accounts should not be limited to the reasons stated above. Each case should be determined upon the particular conditions governing it. The language of rulings under the old income tax law would indicate that legal procedure must be exhausted before an account may be charged off. That, no doubt, is true in many cases, but all accounts do not justify the expenditure of money to effect collection.

Bankruptcy, as a general rule, is sufficient in itself to warrant charging off an account. The average per cent. of dividends paid by the estates of bankrupts to creditors is so small that unless it is apparent that an estate has realizable assets, in a reasonable proportion to the liabilities, the entire account may be charged off at once. Where dividends are received thereon, such dividends should be stated as income.

The question as to when an account is "actually ascertained to be worthless" is one that can best be answered by the creditor, and he might better err on the side of safety than to permit the accumulation of uncollectible accounts.

The Department, in a recent ruling, holds that a debt due from a corporation possessed of assets, cannot be deducted until the affairs of the corporation have been closed and its receiver discharged. Under this decision, the question arises "when is a bankrupt's asset an asset?" Those familiar with bankruptcy practice know that, by a very large margin, the supposed assets of a bankrupt ordinarily "fade away" even in a superficial examination of them, and regardless of representations by the bankrupt, forced sales of what remains, does not, generally speaking, realize more than the cost of administration of the bankrupt's estate.

> "Receipt is acknowledged of your letter of October 3, 1917, wherein you request to be informed: 'Whether there is any rule or regulation prescribing the manner of ascertaining whether a debt is worthless, in order to entitle owner of the worthless debt to deduct its amount in making his income tax return? We are particularly anxious to know whether there must be an unsatisfied judgment or a judicial determination that the debt is worthless. If the creditor knows, of his own knowledge, that the debtor is insolvent and accepts a part of the debt and releases the debtor from the balance of the debt, is the creditor entitled to deduct the amount released in his income tax return?'
>
> "In reply you are advised that this office does not require, in the case of an individual debtor, that an unsatisfied judgment shall exist or a judicial determination be reached in order that a creditor may secure the benefit of a deduction on account of a debt which he considers worthless and uncollectible; but, taking into consideration the time the debt has overrun and the financial condition of the debtor, it is required that it be shown beyond a reasonable doubt that the debt is worthless and uncollectible.
>
> "The office holds that a debt due from a corporation possessed of assets cannot be claimed as a deduction except for the year during which the corporation's affairs are finally closed and its receiver in bankruptcy discharged; and where a creditor, to protect himself from a total loss, enters into a compromise agreement under the terms of which he accepts a part payment of a debt and releases the debtor from payment of the balance, the unpaid portion may be claimed as a deduction." (Letter to Wollman and

Wollman, New York, N. Y., signed by Commissioner Daniel C. Roper, and dated October 16, 1917.)

The main report calls for the amount of bonded and other interest-bearing indebtedness outstanding at the close of the year, exclusive of indebtedness wholly secured by collateral, the subject of sale or hypothecation in the ordinary business of the corporation. **Interest-bearing Indebtedness.**

The supplementary statement calls for details by classification, rate of interest and amount of principal of all interest-bearing indebtedness. This includes all the items called for in the body of the report, and in addition thereto, the total amount owing, etc., on debts, wholly secured by collateral, the subject of sale in the ordinary business of the corporation.

It will be noted that no provision has been made for a merchandise account; instead, separate accounts have been recommended, consisting of Sales, Purchases, Return Sales and Inventory. Return purchases, ordinarily, may be credited to Purchase Account. A Merchandise Account has no place in a modern set of books. **Merchandise Account.**

No postings should be made to the Profit and Loss Account during the interim of a fiscal period, that is to say, until the books are closed at the end of the year. **Profit and Loss Account.**

The practice of charging or crediting expenses or losses and income, respectively, direct to Profit and Loss Account, makes it necessary to analyze the account in order to allocate the items contained therein for purposes of the tax return. But apart from this disadvantage and as a matter of good accounting, Profit and Loss Account should contain no entries until the close of the fiscal period. In the meantime all items of income and expense should be credited or charged to accounts that by their titles are descriptive of their contents.

After the books have been closed the balance of Profit and Loss Account should be transferred either to Surplus or Impairment of Capital Account, as the case may be.

Dividends declared should be charged to Surplus Account and credited to Dividend Account against which the payments of dividends should be charged. **Dividends Declared.**

For the purpose of future reference, the net income as shown

by the return of net income should be reconciled with the result shown by Profit and Loss Account. The difference, where the return is made for the fiscal year of the corporation, will consist of such items of income as are not taxable, readjustment of book values to express appraisal valuations or expenses or losses not by law deductible.

Reconciliation of Return with Books of Account.

Items are not deductible unless they are charged off in the books of account within the year covered by the return.

"A manufacturing corporation may include as an element of the cost of manufactured products, the cost of raw material, the cost of labor of the men who actually work on such products, as well as the cost of supervisory, or what may be designated as 'unproductive labor,' such as that of the foremen, inspectors, overseers, etc., provided such expenditures are not separately deducted from gross income in the Return of Annual Net Income.

Manufacturing Corporations Operating Cost-System.

"The overhead charges referred to in Form 1031 should include the salaries of officers, clerk hire, and such other office expenses as do not have to do directly with the manufacture of the product." (T. D. 2152.)

This ruling under the old law, and provisions with respect to account keeping of the Act of Sept. 8, 1916, makes it possible for manufacturing corporations employing cost-systems, that are embraced in the general books of account and subject to proof as to accuracy, to make their returns on the basis of cost of production, as shown thereby. The form of the return (1031, Revised), however, is not well adapted to that kind of report. For example, it calls for items under "Deductions" that ordinarily (according to opinion of the cost accountant) are charged to the cost of production, as rent, fuel, light and power, repairs, payments in lieu of rent, depreciation, depletion and taxes. Any of these items that are included in the cost of production through the cost-system, should not again be stated as deductions.

Items that have been included in the cost of production that are separately provided for in the report or supplementary statement thereof, should be explained by a notation "included in cost of manufacture." The detailed information as to basis of

computing depreciation and depletion, and amount of domestic and foreign taxes charged to the period, should be furnished in the supplementary statement even though these items, or either of them, were included in the cost of manufactured goods.

Where interest on capital is theoretically added to the cost of production, such interest, for income tax purposes, must either be deducted from the cost of production or separately stated as income in the return.

It is quite usual to maintain, in connection with a modern cost-system, a "perpetual" or "running" inventory. Irrespective of the degree of care with which such inventory may be operated, more or less differences occur in the course of time. This necessitates the taking of physical inventories and the adjustment of the "running" inventory therewith. Physical inventories should be taken and the book inventory reconciled therewith at least once in each fiscal period.

The profit or loss of a manufacturing or mercantile business, dealing in merchandise, cannot be determined without stating inventories as at the beginning and end of the fiscal period. Where practicable, it is required that a physical inventory—by actual count—be taken. Equivalent inventories are acceptable only when stock-taking by count is not obtainable. **Inventory Equivalent.**

> In order that certain classes of corporations may arrive at their correct income, it is necessary that an inventory, or its equivalent, of materials, supplies, and merchandise on hand for use or sale at the close of each calendar year shall be made in order to determine the gross income or to determine the expense of operation.
>
> A physical inventory is at all times preferred, but where a physical inventory is impossible and an equivalent inventory is equally accurate, the latter will be acceptable.
>
> An equivalent inventory is an inventory of materials, supplies, and merchandise on hand taken from the books of the corporation. (Art. 161, Reg. 33.)

It has been ruled that materials and supplies purchased must be credited with such part thereof as has not been used up; that is to say, inventory of the unused portion thereof must be deducted from the pur- **Materials and Supplies Used.**

chases in computing the amount chargeable to expense or cost of operations.

> In ascertaining expenses proper to be included in the deductions to be made under the item of "Expenses," corporations carrying materials and supplies on hand for use should include in such expenses the charges for materials and supplies only to the amount that the same are actually disbursed and used in operation and maintenance during the year for which the return is made. (Art. 123, Reg. 33.)

APPENDIX A

FEDERAL INCOME TAX LAW

ENACTED SEPTEMBER 8, 1916

as amended by

the Acts of March 3, 1917, and October 3, 1917

PART I.—ON INDIVIDUALS

SEC. 1. (a) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources within the United States by every individual, a nonresident alien, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise. **Normal Tax.**

(b) In addition to the income tax imposed by subdivision (a) of this section (herein referred to as the normal tax) there shall be levied, assessed, collected, and paid upon the total net income of every individual, or, in the case of a nonresident alien, the total net income received from all sources within the United States, an additional income tax (herein referred to as the additional tax) of one per centum per annum upon the payment by which such total net income exceeds $20,000 and does not exceed $40,000, two per centum per annum upon the amount by which such total net income exceeds $40,000 and does not exceed $60,000, three per centum per annum upon the amount by which such total net income exceeds $60,000 and does not exceed $80,000, four per centum per annum upon the amount by which such total net income exceeds $80,000 and does not exceed $100,000, five per centum per annum upon the amount by which such total net income exceeds $100,000 and does not exceed $150,000, six per centum per annum upon the amount by which such total net income exceeds $150,000 and does not exceed $200,000, seven per centum per annum upon the amount by which such total net income exceeds $200,000 and does not exceed $250,000, eight per centum per annum upon the amount by which such total net income exceeds $250,000 and does not exceed $300,000, nine per centum per annum upon the amount by which such total net income exceeds $300,000 and does not exceed $500,000, ten per centum per annum upon the amount by which such total net income, exceeds $500,000, and does not exceed $1,000,000, eleven per centum per **Additional Tax.**

annum upon the amount by which such total net income exceeds $1,000,000 and does not exceed $1,500,000, twelve per centum per annum upon the amount by which such total net income exceeds $1,500,000 and does not exceed $2,000,000, and thirteen per centum per annum upon the amount by which such total net income exceeds $2,000,000.

Dividends Subject to Additional Tax.

For the purpose of the additional tax there shall be included as income the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company, except that in the case of non-resident aliens such income derived from sources without the United States shall not be included.

All the provisions of this title relating to the normal tax on individuals, so far as they are applicable and are not inconsistent with this subdivision and section three, shall apply to the imposition, levy, assessment, and collection of the additional tax imposed under this subdivision.

Calendar Year.

(c) The foregoing normal and additional tax rates shall apply to the entire net income, except as hereinafter provided, received by every taxable person in the calendar year nineteen hundred and sixteen and in each calendar year thereafter.

Income Defined

Net Income of Individuals Defined.

[1] Sec. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income, derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

Income of Estates.

(b) Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, the tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be: *Provided*, That where the income is to be distributed annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.

Individual Share of Beneficiaries.

[1] Amendment.

Such trustees, executors, administrators, and other fiduciaries are hereby indemnified against the claims or demands of every beneficiary for all payments of taxes which they shall be required to make under the provisions of this title, and they shall have credit for the amount of such payments against the beneficiary or principal in any accounting which they make as such trustees or other fiduciaries. **Indemnity to Fiduciaries.**

(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived. **Basis of Determining Gain on Property Acquired Prior to March 1, 1913.**

ADDITIONAL TAX INCLUDES UNDISTRIBUTED PROFITS

SEC. 3. For the purpose of the additional tax, the taxable income of any individual shall include the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies or associations, or insurance companies, however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed; and the fact that any such corporation, joint-stock company or association, or insurance company, is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company or association, or insurance company shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed. **Undistributed Profits Subject to Additional Tax.** **Unreasonable Accumulation Evidence of Fraud.**

INCOME EXEMPT FROM LAW

[1] SEC. 4. The following income shall be exempt from the provisions of this title: **Tax Exempt Income.**

[1] The proceeds of life insurance policies paid to individual beneficiaries upon the death of the insured; the amount received by the insured, as a return of premium or premiums paid by him **Insurance.**

[1] Amendment.

under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract; the value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included as income); interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States (but, in the case of obligations of the United States issued after September first, nineteen hundred and seventeen, only if and to the extent provided in the Act authorizing the issue thereof) or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen; the compensation of the present President of the United States during the term for which he has been elected and the judges of the supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State, or any political subdivision thereof, except when such compensation is paid by the United States Government.

Gifts, Bequests.

Interest on Obligations of State.

Salaries of Certain Public Officials and Employees.

DEDUCTIONS ALLOWED

SEC. 5. That in computing net income in the case of a citizen or resident of the United States—

Deductions.

(a) For the purpose of the tax there shall be allowed as deductions—

Necessary Expenses.

First. The necessary expenses actually paid in carrying on any business or trade, not including personal, living, or family expenses;

[1] Second. All interest paid within the year on his indebtedness except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title;

Interest.

[1] "Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes) or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits;

Taxes.

Fourth. Losses actually sustained during the year, incurred in his business or trade, or arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided*, That for the purpose of ascertaining the loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss sustained;

Losses in Trade.

Loss on Property Acquired Prior to March 1, 1913.

[1] Amendment.

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom; **Losses not in Trade.**

Sixth. Debts due to the taxpayer actually ascertained to be worthless and charged off within the year; **Bad Debts.**

Seventh. A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; **Depreciation.**

Eighth. (a) In the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowances authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made. **Depletion.** **Limitation of Depletion.** **Improvements not Deductible.**

[1] Ninth. Contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury. **Contributions to Charities.**

Credits Allowed

(b) For the purpose of the normal tax only, the income embraced in a personal return shall be credited with the amount received as dividends upon the stock or from the net earnings of any corporation, joint-stock company or association, trustee, or insurance company, which is taxable upon its net income as hereinafter provided: **Normal Tax Credits.**

[1] Amendment.

Dividends, Taxes Withheld.

(c) A like credit shall be allowed as to the amount of income, the normal tax upon which has been paid or withheld for payment at the source of the income under the provisions of this title.

NONRESIDENT ALIENS

Deductions Nonresident Aliens.

SEC. 6. That in computing net income in the case of a nonresident alien—

(a) For the purpose of the tax there shall be allowed as deductions—

Necessary Expenses.

First. The necessary expenses actually paid in carrying on any business or trade conducted by him within the United States, not including personal, living, or family expenses;

Interest.

[1] Second. The proportion of all interest paid within the year by such person on his indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) which the gross amount of his income for the year derived from sources within the United States bears to the gross amount of his income for the year derived from all sources within and without the United States, but this deduction shall be allowed only if such person includes in the return required by section eight all the information necessary for its calculation;

Taxes.

Third. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits;

Losses.

Fourth. Losses actually sustained during the year, incurred in business or trade conducted by him within the United States, and losses of property within the United States arising from fires, storm, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise: *Provided*, That for the purpose of ascertaining the amount of such loss or losses sustained in trade, or speculative transactions not in trade, from the same or any kind of property acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such loss or losses sustained;

Ascertaining Amount of Loss.

Losses not in Trade.

Fifth. In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom in the United States;

Bad Debts.

Sixth. Debts arising in the course of business or trade conducted by him within the United States due to the taxpayer actually ascertained to be worthless and charged off within the year;

[1] Amendment.

Seventh. A reasonable allowance for the exhaustion, wear and tear of property within the United States arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof, which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made. No deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made.

Depreciation.

Limitation of Depletion.

Improvements not Deductible.

(b) There shall also be allowed the credits specified by subdivisions (b) and (c) of section five.

Credits.

[1] (c) A nonresident alien individual shall receive the benefit of the deductions and credits provided for in this section only by filing or causing to be filed with the collector of internal revenue a true and accurate return of his total income, received from all sources, corporate or otherwise, in the United States, in the manner prescribed by this title; and in case of his failure to file such return the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax.

Deductions Contingent on Filing Return.

Personal Exemption

[1] Sec. 7. That for the purpose of the normal tax only, there shall be allowed as an exemption in the nature of a deduction from the amount of the net income of each citizen or resident of the United States, ascertained as provided herein, the sum of $3,000, plus $1,000 additional if the person making the return be a head of a family or a married man with a wife living with him, or plus the sum of $1,000 additional if the person making the return be a married woman with a husband living with her; but in no event shall this additional exemption of $1,000 be deducted by both a husband and a wife: *Provided*, That only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together: *Provided further*, That if the person making the return is the head

Specific Exemptions, Citizens and Residents only.

[1] Amendment.

of a family there shall be an additional exemption of $200 for each child dependent upon such person, if under eighteen years of age, or if incapable of self-support because mentally or physically defective, but this provision shall operate only in the case of one parent in the same family: *Provided further*, That guardians or trustees shall be allowed to make this personal exemption as to income derived from the property of which such guardian or trustee has charge in favor of each ward or cestui que trust: *Provided further*, That in no event shall a ward or cestui que trust be allowed a greater personal exemption than as provided in this section, from the amount of net income received from all sources. There shall also be allowed an exemption from the amount of the net income of estates of deceased citizens or residents of the United States during the period of administration or settlement, and of trust or other estates of citizens or residents of the United States the income of which is not distributed annually or regularly under the provisions of subdivision (b) of section two, the sum of $3,000, including such deductions as are allowed under section five.

RETURNS

Returns of Net Income.

SEC. 8. (a) The tax shall be computed upon the net income, as thus ascertained, of each person subject thereto, received in each preceding calendar year ending December thirty-first.

When and With Whom to File Return.

(b) On or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, a true and accurate return under oath shall be made by each person of lawful age, except as hereinafter provided, having a net income of $3,000 or over for the taxable year to the collector of internal revenue for the district in which such person has his legal residence or principal place of business, or if there be no legal residence or place of business in the United States, then with the collector of internal revenue at Baltimore, Maryland, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources, and from the total thereof deducting the aggregate items of allowances herein authorized; *Provided*, That the Commissioner of Internal Revenue shall have authority to grant a reasonable extension of time, in meritorious cases, for filing returns of income by persons residing or traveling abroad who are required to make and file returns of income and who are unable to file said returns on or before March first of each year: *Provided further*, That the aforesaid return may be made by an agent when by reason of illness, absence, or nonresidence the person liable for said return is unable to make and render the same, the agent assuming the responsibility of making the return and incurring penalties provided for erroneous, false, or fraudulent return.

Extension of Time to File Return.

Return by Agent.

[1] (c) Guardians, trustees, executors, administrators, receivers, con-

[1] Amendment.

servators, and all persons, corporations, or associations, acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. Such fiduciary shall make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make such return and that the same is, to the best of his knowledge and belief, true and correct, and be subject to all the provisions of this title which apply to individuals: *Provided*, That a return made by one of two or more joint fiduciaries filed in the district where such fiduciary resides, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph: *Provided further*, That no return of income not exceeding $3,000 shall be required except as in this title otherwise provided.

Returns by Guardians, Trustees, Receivers.

Fiduciaries.

(d) Repealed.

[1] (e) Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid under the provisions of this title: *Provided*, That from the net distributive interests on which the individual members shall be liable for tax, normal and additional, there shall be excluded their proportionate shares received from interests on the obligations of a State or any political or taxing subdivision thereof, and upon the obligations of the United States (if and to the extent that it is provided in the Act authorizing the issue of such obligations of the United States that they are exempt from taxation), and its possessions, and that for the purpose of computing the normal tax there shall be allowed a credit, as provided by section five, subdivision (b), for their proportionate share of the profits derived from dividends. Such partnership, when requested by the Commissioner of Internal Revenue or any district collector, shall render a correct return of the earnings, profits, and income of the partnership, except income exempt under section four of this Act, setting forth the item of the gross income and the deductions and credits allowed by this title, and the names and addresses of the individuals who would be entitled to the net earnings, profits, and income, if distributed. A partnership shall have the same privilege of fixing and making returns upon the basis of its own fiscal year as is accorded to corporations under this title. If a fiscal year ends during nineteen hundred and sixteen or a subsequent calendar year for which there is a rate of tax different from the rate for the preceding calendar year, then (1) the rate for such preceding calendar year shall apply to an amount of each partner's share of such partnership profits equal to the proportion which the part of such fiscal

Partnerships.

Interest on State Obligations Excluded.

Returns by Partnerships.

Fiscal Year.

[1] Amendment.

year falling within such calendar year bears to the full fiscal year, and (2) the rate for the calendar year during which such fiscal year ends shall apply to the remainder.

(f) In every return shall be included the income derived from dividends on the capital stock or from the net earnings of any corporation, joint-stock company or association, or insurance company, except that in the case of nonresident aliens such income derived from sources without the United States shall not be included.

Dividends Returnable.

(g) An individual keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect his income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make his return upon the basis upon which his accounts are kept, in which case the tax shall be computed upon his income as so returned.

Basis of Keeping Accounts.

ASSESSMENT AND ADMINISTRATION

SEC. 9. (a) That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said amounts shall be paid on or before the fifteenth day of June, except in cases of refusal or neglect to make such return and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, or has been made, make a return upon information obtained as provided for in this title or by existing law, or require the necessary corrections to be made, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the fifteenth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid, and interest at the rate of one per centum per month upon said tax from the time the same became due, except from the estates of insane, deceased, or insolvent persons.

When Tax is Payable.

Penalty Delayed Payments.

[1] (b) All persons, corporations, partnerships, associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical gains, profits, and income of any nonresident

Withholding Tax on Income of Nonresident Aliens.

[1] Amendment.

alien individual, other than income derived from dividends on capital stock, or from the net earnings of a corporation, joint-stock company or association, or insurance company, which is taxable upon its net income as provided in this title, are hereby authorized and required to deduct and withhold from such annual or periodical gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this title, and shall make return thereof on or before March first of each year and, on or before the time fixed by law for the payment of the tax, shall pay the amount withheld to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax, and they are each hereby indemnified against every person, corporation, partnership, association, or insurance company, or demand whatsoever for all payments which they shall make in pursuance and by virtue of this title.

Exclusive of Dividends.

[1] (c) The amount of the normal tax hereinbefore imposed shall also be deducted and withheld from fixed or determinable annual or periodical gains, profits and income derived from interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies, (if such bonds, mortgages, or other obligations contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee or to reimburse the obligee for any portion of the tax or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States) whether payable annually or at shorter or longer periods and whether such interest is payable to a nonresident alien individual or to an individual citizen or resident of the United States, subject to the provisions of the foregoing subdivision (b) of this section requiring the tax to be withheld at the source and deducted from annual income and returned and paid to the Government, unless the person entitled to receive such interest shall file with the withholding agent, on or before February first, a signed notice in writing claiming the benefit of an exemption under section seven of this Title.

Withholding Tax on Interest on Bonds containing Tax-free Covenant.

(d) Repealed.

(e) Repealed.

[1] (f) All persons, corporations, partnerships, or associations, undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Goverament to obtain the information required under this title, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and whoever knowingly undertakes to collect such payments as aforesaid without having obtained a license therefor, or without

License Required by Collectors of Foreign Payments.

[1] Amendment.

complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding $5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

General Assessment of Income. (g) The tax herein imposed upon gains, profits, and incomes not falling under the foregoing and not returned and paid by virtue of the foregoing or as otherwise provided by law shall be assessed by personal return under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. The intent and purpose of this title is that all gains, profits, and income of a taxable class, as defined by this title, shall be charged and assessed with the corresponding tax, normal and additional, prescribed by this title, and said tax shall be paid by the owner of such income, or the proper representative having the receipt, custody, control, or disposal of the same. For the purpose of this title ownership or liability shall be determined as of the year for which a return is required to be rendered.

Intent of the Law.

Withholding Applies only to Normal Tax. The provisions of this section, except subdivision (c), relating to the deduction and payment of the tax at the source of income shall only apply to the normal tax hereinbefore imposed upon nonresident alien individuals.

PART II.—ON CORPORATIONS

Income of Corporations. [1] SEC. 10. (a) That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized, but not including partnerships, a tax of two per centum upon such income; and a like tax shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources within the United States by every corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including the income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies or associations, or insurance companies, whose net income is taxable under this title.

Rate.

Calendar or Fiscal Year. The foregoing tax rate shall apply to the total net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and sixteen and in each year thereafter, except that if it has fixed its own fiscal year under the provisions of existing law, the foregoing rate shall apply to the proportion of the total net income returned

[1] Amendment.

for the fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, which the period between January first, nineteen hundred and sixteen, and the end of such fiscal year bears to the whole of such fiscal year, and the rate fixed in Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," shall apply to the remaining portion of the total net income returned for such fiscal year.

Ascertaining Profit or Loss.

For the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition by a corporation, joint-stock company or association, or insurance company, of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived or loss sustained.

Undistributed Profits Tax on Corporations.

[1] (b) In addition to the income tax imposed by subdivision (a) of this section there shall be levied, assessed, collected, and paid annually an additional tax of ten per centum upon the amount, remaining undistributed six months after the end of each calendar or fiscal year, of the total net income of every corporation, joint-stock company or association, or insurance company, received during the year, as determined for the purposes of the tax imposed by such subdivision (a), but not including the amount of any income taxes paid by it within the year imposed by the authority of the United States.

Certain Invested Income Exempt.

[1] The tax imposed by this subdivision shall not apply to that portion of such undistributed net income which is actually invested and employed in the business or is retained for employment in the reasonable requirements of the business or is invested in obligations of the United States issued after September first, nineteen hundred and seventeen: *Provided*, That if the Secretary of the Treasury ascertains and finds that any portion of such amount so retained at any time for employment in the business is not so employed or is not reasonably required in the business a tax of fifteen per centum shall be levied, assessed, collected, and paid thereon.

Additional Tax.

Applicable to Year 1917 and Thereafter.

[1] The foregoing tax rates shall apply to the undistributed net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and seventeen and in each year thereafter, except that if it has fixed its own fiscal year under the provisions of existing law, the foregoing rates shall apply to the proportion of the taxable undistributed net income returned for the fiscal year ending prior to December thirty-first, nineteen hundred and seventeen, which the period between January first, nineteen hundred and seventeen, and the end of such fiscal year bears to the whole of such fiscal year.

[1] Amendment.

CONDITIONAL AND OTHER EXEMPTIONS

SEC. 11. (a) That there shall not be taxed under this title any income received by any—

Organizations Not Taxable.

First. Labor, agricultural, or horticultural organization.

Second. Mutual savings bank not having a capital stock represented by shares;

Third. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

Fourth. Domestic building and loan association and coöperative banks without capital stock organized and operated for mutual purposes and without profit;

Fifth. Cemetery company owned and operated exclusively for the benefit of its members;

Sixth. Corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

Seventh. Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

Eighth. Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

Ninth. Club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

Tenth. Farmers' or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or coöperative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

Eleventh. Farmers', fruit growers', or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth. Federal land banks and national farm-loan associations as provided in section twenty-six of the Act approved July seventeenth, nineteen hundred and sixteen, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market

for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Fourteenth. Joint-stock land banks as to income derived from bonds or debentures of other joint-stock land banks or any Federal land bank belonging to such joint-stock land bank.

(b) There shall not be taxed under this title any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico: *Provided*, That whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this title, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this title upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this title upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

Income from Public Utility.

State and Municipal Income Exempt.

DEDUCTIONS

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

Deductions Allowed to Domestic Corporations.

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

Necessary Expenses.

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return

Losses.

Depreciation.

Depletion.

and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made: *Provided further*, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;

Limitation of Depletion.

Improvements.

Income of Mutual Companies.

[1] Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding: *Provided*, That for the purpose of this title preferred capital stock shall not be considered interest-bearing indebtedness, and interest or dividends paid upon this stock shall not be deductible from gross income: *Provided further*, That in cases wherein shares of capital stock are issued without par or nominal value, the amount of paid-up capital

Interest.

Limitation of Interest Deductible.

[1] Amendment.

stock, within the meaning of this section, as represented by such shares, will be the amount of cash, or its equivalent, paid or transferred to the corporation as a consideration for such shares: *Provided further*, That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company, or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral: *Provided further*, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed, or any other tax paid pursuant to such guaranty, shall be allowed; and in the case of a bank, banking association, loan or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company shall be deducted.

[1] Fourth. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or any foreign country, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, not including those assessed against local benefits. **Taxes Deductible. Exceptions.**

(b) In the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources within the United States— **Net Income of Foreign Corporations.**

First. All the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity. **Deductions Allowed Foreign Corporations.**

Second. All losses actually sustained within the year in business or trade conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) and in the case (a) of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, **Losses. Depreciation.**

[1] Amendment.

Depletion. but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to be prescribed by the Secretary of the Treasury: *Provided*, That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; and (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That no deduction shall be allowed for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made: *Provided further*, That mutual fire and mutual employers' liability and mutual workmen's compensation and mutual casualty insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof, and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;

Limitation of Depletion.

Improvements.

Mutual Companies.

[1] Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the proportion of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of the capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding, which the gross amount

Interest.

Limitation of Interest Deductible.

[1] Amendment.

of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States: *Provided*, That in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed or any other tax paid pursuant to such guaranty shall be allowed; and in case of a bank, banking association, loan or trust company, or branch thereof, interest paid within the year on deposits by or on moneys received for investment from either citizens or residents of the United States and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company, or branch thereof;

Fourth. Taxes paid within the year imposed by the authority of the United States (except income and excess profits taxes), or of its Territories, or possessions, or by the authority of any State, county, school district, or municipality, or other taxing subdivision of any State, paid within the United States, not including those assessed against local benefits. **Taxes Deductible. Exceptions.**

(c) In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds. **Reserve Insurance Companies.**

RETURNS

SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first: *Provided*, That any corporation, joint-stock company or association, or insurance company, subject to this tax, may designate the last day of any month in the year as the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for the calendar year preceding the date of assessment; and it shall give notice of the day it has thus designated as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the first day of March of the year in which its return would be filed if made upon the basis of the calendar year; **Tax Year. Fiscal Year.**

(b) Every corporation, joint-stock company or association, or insurance company, subject to the tax herein imposed, shall, on or before the first day of March, nineteen hundred and seventeen, and the first day of March in each year thereafter, or, if it has designated a fiscal year for the computation of its tax, then within sixty days after the close of such fiscal year ending prior to December thirty-first, nineteen hundred and sixteen, and the close of each such fiscal year thereafter, render **Return When Due.**

a true and accurate return of its annual net income in the manner and form to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, and containing such facts, data, and information as are appropriate and in the opinion of the commissioner necessary to determine the correctness of the net income returned and to carry out the provisions of this title. The return shall be sworn to by the president, vice president, or other principal officer, and by the treasurer or assistant treasurer. The return shall be made to the collector of the district in which is located the principal office of the corporation, company, or association, where are kept its books of account and other data from which the return is prepared, or in the case of a foreign corporation, company, or association, to the collector of the district in which is located its principal place of business in the United States, or if it have no principal place of business, office, or agency in the United States, then to the collector of internal revenue at Baltimore, Maryland. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue;

Sworn to by Two Officers of Corporation.

Where to File Return.

(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control;

Receivers, Trustees, etc., Must Make Returns.

(d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;

Basis of Keeping Accounts.

[1] (e) All the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of nonresident alien individuals from sources within the United States shall be made applicable to the tax imposed by subdivision (a) of section ten upon incomes derived from interest upon bonds and mortgages or deeds of trust or similar obligations of domestic or other resident corporations, joint-stock companies or associations, and insurance com-

Withholding Tax on Incomes of Foreign Corporations.

[1] Amendment.

panies by nonresident alien firms, copartnerships, companies, corporations, joint-stock companies or associations, and insurance companies, not engaged in business or trade within the United States and not having any office or place of business therein.

(f) Likewise, all the provisions of this title relating to the tax authorized and required to be deducted and withheld and paid to the officer of the United States Government authorized to receive the same from the income of nonresident alien individuals from sources within the United States shall be made applicable to income derived from dividends upon the capital stock or from the net earnings of domestic or other resident corporations, joint-stock companies or associations, and insurance companies by nonresident alien companies, corporations, joint-stock companies or associations, and insurance companies not engaged in business or trade within the United States and not having any office or place of business therein.

Dividends.

Nonresident Organizations.

ASSESSMENT AND ADMINISTRATION

SEC. 14. (a) All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or before the fifteenth day of June; *Provided*, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and five days after the date upon which it is required to file its list or return of income for assessment; except in cases of refusal or neglect to make such return, and in cases of erroneous, false, or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this title or by existing law; and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the fifteenth day of June in any year, or after one hundred and five days from the date on which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due; *Provided*, That upon the examination of any return of income made pursuant to this title, the Act of August fifth, nineteen hundred and nine, entitled, "An Act to provide revenue, equalize duties and encourage the industries of the United States, and for other purposes," and the Act of October third, nineteen hundred and thirteen, entitled, "An Act to reduce

Assessments.

Payment of Tax When Due.

Penalty Delayed Payment.

tariff duties and to provide revenue for the Government, and for other purposes," if it shall appear that amounts of tax have been paid in excess of those properly due, the taxpayer shall be permitted to present a claim for refund thereof notwithstanding the provisions of section thirty-two hundred and twenty-eight of the Revised Statutes;

(b) When the assessment shall be made, as provided in this title, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such; *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President; *Provided further*, That the proper officers of any State imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint-stock company or association, or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe;

Returns Constitute Public Records.

Conditions of Inspection.

(c) If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding $10,000; *Provided*, That the Commissioner of Internal Revenue shall have authority, in the case of either corporations or individuals, to grant a reasonable extension of time in meritorious cases, as he may deem proper.

Penalty Refusal to Make Return and Making False Return.

(d) That section thirty-two hundred and twenty-five of the Revised Statutes of the United States be, and the same is hereby, amended so as to read as follows:

"SEC. 3225. When a second assessment is made in case of any list, statement, or return, which in the opinion of the collector or deputy collector was false or fraudulent, or contained any understatement or undervaluation, no tax collected under such assessment shall be recovered by any suit unless it is proved that the said list, statement, or return was not false nor fraudulent and did not contain any understatement or undervaluation; but this section shall not apply to statements or returns made or to be made in good faith under the laws of the United States, regarding annual depreciation of oil or gas wells and mines."

Second Assessment.

PART III.—GENERAL ADMINISTRATIVE PROVISIONS

SEC. 15. That the word "State" or "United States" when used in this title shall be construed to include any Territory, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions.

"State" "United States" Defined.

SEC. 16. That sections thirty-one hundred and sixty-seven, thirty-one hundred and seventy-two, thirty-one hundred and seventy-three, and thirty-one hundred and seventy-six of the Revised Statutes of the United States as amended are hereby amended so as to read as follows:

"SEC. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment. **Disclosing Information Prohibited.**

"SEC. 3172. Every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal-revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects. **Collector's Duty.**

"SEC. 3173. It shall be the duty of any person, partnership, firm, association, or corporation, made liable to any duty, special tax, or other tax imposed by law, when not otherwise provided for, (1) in case of a special tax, on or before the thirty-first day of July in each year, (2) in case of income tax on or before the first day of March in each year, or on or before the last day of the sixty-day period next following the closing date of the fiscal year for which it makes a return of its income, and (3) in other cases before the day on which the taxes accrue, to make a list or return, verified by oath, to the collector or a deputy collector of the district where located, of the articles or objects, including the amount of annual income charged with a duty or tax, the quantity of goods, wares, and merchandise, made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, for which such person, partnership, firm, association, or corporation is liable: *Provided*, That if any person liable to pay any duty or tax, or owning, possessing, or having the care or management of property, goods, wares, and merchandise, article or objects liable to pay any duty, tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of **Provisions of Administration.**

any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which, being distinctly read, consented to, and signed and verified by oath by the person so owning, possessing, or having the care and management as aforesaid, may be received as the list of such person: *Provided further*, That in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath. And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at the time required, or delivers any return which, in the opinion of the collector, is erroneous, false, or fraudulent, or contains any undervaluation or understatement, or refuses to allow any regularly authorized Government officer to examine the books of such person, firm, or corporation, it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person, or any other person he may deem proper, to appear before him and produce such books at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects or income liable to tax or the returns thereof. The collector may summon any person residing or found within the State or Territory in which his district lies; and when the person intended to be summoned does not reside and cannot be found within such State or Territory, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned: *Provided*, That "person," as used in this section, shall be construed to include any corporation, joint-stock company or association, or insurance company when such construction is necessary to carry out its provisions.

Returns, Collectors.

SEC. 3176. If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. Any return or list so made and subscribed by a collector or deputy collector shall be prima facie good and sufficient for all legal purposes.

When Collector May Prepare Return.

If the failure to file a return or list is due to sickness or absence the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper. **Extension of Time.**

"The Commissioner of Internal Revenue shall assess all taxes, other than stamp taxes, as to which returns or lists are so made by a collector or deputy collector. In case of any failure to make and file a return or list within the time prescribed by law or by the collector, the Commissioner of Internal Revenue shall add to the tax fifty per centum of its amount except that, when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per centum of its amount. **Penalties for Failure to File Returns.** **False Return.**

"The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax."

SEC. 17. That it shall be the duty of every collector of internal revenue, to whom any payment of any taxes is made under the provisions of this title, to give to the person making such payment a full written or printed receipt, expressing the amount paid and the particular account for which such payment was made; and whenever such payment is made such collector shall, if required, give a separate receipt for each tax paid by any debtor, on account of payments made to or to be made by him to separate creditors in such form that such debtor can conveniently produce the same separately to his several creditors in satisfaction of their respective demands to the amounts specified in such receipts; and such receipts shall be sufficient evidence in favor of such debtor to justify him in withholding the amount therein expressed from his next payment to his creditor; but such creditor may, upon giving to his debtor a full written receipt, acknowledging the payment to him of whatever sum may be actually paid, and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt. **Receipt for Payment of Tax.**

[1] SEC. 18. That any person, corporation, partnership, association, or insurance company, liable to pay the tax, to make a return or to supply information required under this title, who refuses or neglects to pay such tax, to make such return or to supply such information at the time or times herein specified in each year, shall be liable, except as otherwise specially provided in this title, to a penalty of not less than $20 nor more than $1,000. Any individual or any officer of any corporation, partnership, association, or insurance company, required by law to make, render, sign, or verify any return or to supply any information, who makes any false or fraudulent **Penalty for Refusal or Neglect to Make Return.**

[1] Amendment.

return or statement with intent to defeat or evade the assessment required by this title to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, in the discretion of the court, with the costs of prosecution: *Provided*, That where any tax heretofore due and payable has been duly paid by the taxpayer, it shall not be re-collected from any withholding agent required to retain it at its source, nor shall any penalty be imposed or collected in such cases from the taxpayer, or such withholding agent whose duty it was to retain it, for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment."

SEC. 19. The collector or deputy collector shall require every return to be verified by the oath of the party rendering it. If the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly. Such person may furnish sworn testimony to prove any relevant facts, and, if dissatisfied with the decision of the collector, may appeal to the Commissioner of Internal Revenue for his decision under such rules of procedure as may be prescribed by regulation.

Returns Verified by Oath.

Right of Appeal.

SEC. 20. That jurisdiction is hereby conferred upon the district courts of the United States for the district within which any person summoned under this title to appear to testify or to produce books shall reside, to compel such attendance, production of books, and testimony by appropriate process.

Jurisdiction of District Court.

SEC. 21. That the preparation and publication of statistics reasonably available with respect to the operation of the income tax law and containing classifications of taxpayers and of income, the amounts allowed as deductions and exemptions, and any other facts deemed pertinent and valuable, shall be made annually by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

Statistics.

SEC. 22. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed and not inconsistent with the provisions of this title, are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed.

SEC. 23. That the provisions of this title shall extend to Porto Rico and the Philippine Islands; *Provided*, That the administration of the law and the collection of the taxes imposed in Porto Rico and the Philippine Islands shall be by the appropriate internal-revenue officers of those governments, and all revenues collected in Porto Rico and the Philippine Islands thereunder shall accrue intact to the general Governments thereof, respectively: *Provided further*, That the jurisdiction in this title conferred upon the district courts of the United States shall, so far as the Philippine Islands are concerned, be vested in the

Porto Rico, Philippine Islands.

courts of the first instance of said islands; *And provided further*, That nothing in this title shall be held to exclude from the computation of the net income the compensation paid any official by the governments of the District of Columbia, Porto Rico, and the Philippine Islands, or the political subdivisions thereof.

SEC. 24. That Section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," is hereby repealed, except as herein otherwise provided, and except that it shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued or may accrue in relation to any of such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the adminitsration of such section or any provision thereof shall be available for the administration of this title or the corresponding provision thereof. **Repeal of Income Tax Act of 1913.**

SEC. 25. That income on which has been assessed the tax imposed by Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October third, nineteen hundred and thirteen, shall not be considered as income within the meaning of this title; *Provided*, That this section shall not conflict with that portion of section ten, of this title, under which a taxpayer has fixed its own fiscal year.

[1] SEC. 26. Every corporation, joint-stock company or association, or insurance company subject to the tax herein imposed, when required by the Commissioner of Internal Revenue, shall render a correct return, duly verified under oath, of its payments of dividends, whether made in cash or its equivalent or in stock, including the names and addresses of stockholders and the number of shares owned by each, and the tax years and the applicable amounts in which such dividends were earned, in such form and manner as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury. **Returns of Dividends by Corporations.**

[1] SEC. 27. That every person, corporation, partnership, or association, doing business as a broker on any exchange or board of trade or other similar place of business shall, when required by the Commissioner of Internal Revenue, render a correct return duly verified under oath, under such rules and regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, showing the names of customers for whom such person, corporation, partnership, or association has transacted any business, with such details as to the profits, losses, or other information which the commissioner may require, as to each of such customers, as will enable the Commissioner of Internal Revenue to determine whether all income tax due on profits or gains of such customers has been paid. **Returns by Brokers.**

[1] Amendment.

[1] SEC. 28. That all persons, corporations, partnerships, associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, receivers, conservators, and employers, making payment to another person, corporation, partnership, association, or insurance company, of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections twenty-six and twenty-seven), of $800 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, are hereby authorized and required to render a true and accurate return to the Commissioner of Internal Revenue, under such rules and regulations and in such form and manner as may be prescribed by him, with the approval of the Secretary of the Treasury, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment: *Provided*, That such returns shall be required, regardless of amounts, in the case of payments of interest upon bonds and mortgages or deeds of trust or other similar obligations of corporations, joint-stock companies, associations, and insurance companies, and in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest from the bonds and dividends from the stock of foreign corporations by persons, corporations, partnerships, or associations, undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

Returns. "Information at Source."

Returns. Interest on Bonds.

When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person, corporation, partnership, association, or insurance company paying the income.

The provisions of this section shall apply to the calendar year nineteen hundred and seventeen and each calendar year thereafter, but shall not apply to the payment of interest on obligations of the United States.

Excess Profits Tax. Assessment Creditable in Income Tax Return.

SEC. 29. That in assessing income tax the net income embraced in the return shall also be credited with the amount of any excess profits tax imposed by Act of Congress and assessed for the same calendar or fiscal year upon the taxpayer, and, in the case of a member of a partnership, with his proportionate share of such excess profits tax imposed upon the partnership.

Tax not Applicable

[1] SEC. 30. That nothing in section II of the Act approved October third, nineteen hundred and thirteen, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," or in this title, shall be construed as

[1] Amendment.

taxing the income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to foreign governments. **to Income of Foreign Governments.**

[1] SEC. 31. (a) That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of the earnings or profits so distributed. **"Dividends" Defined.**

(b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, but nothing herein shall be construed as taxing any earnings or profits accrued prior to March first, nineteen hundred and thirteen, but such earnings or profits may be distributed in stock dividends or otherwise, exempt from the tax, after the distribution of earnings and profits accrued since March first, nineteen hundred and thirteen, has been made. This subdivision shall not apply to any distribution made prior to August sixth, nineteen hundred and seventeen, out of earnings or profits accrued prior to March first, nineteen hundred and thirteen. **Dividends Deemed to have been Paid out of most recently Earned Profits.**

[1] SEC. 32. That premiums paid on life insurance polices covering the lives of officers, employees, or those financially interested in any trade or business conducted by an individual, partnership, corporation, joint-stock company or association, or insurance company, shall not be deducted in computing the net income of such individual, corporation, joint-stock company or association, or insurance company, or in computing the profits of such partnership for the purposes of subdivision (e) of section nine. **Premiums Life Insurance Policies in Favor of Corporations and Partnerships.**

[1] SEC. 1212. That any amount heretofore withheld by any withholding agent as required by Title I of such Act of September eighth, nineteen hundred and sixteen, on account of the tax imposed upon the income of any individual, a citizen or resident of the United States, for the calendar year nineteen hundred and seventeen, except in the cases covered by subdivision (c) of section nine **Releasing Taxes withheld.**

[1] Amendment.

of such Act, as amended by this Act, shall be released and paid over to such individual, and the entire tax upon the income of such individual for such year shall be assessed and collected in the manner prescribed by such Act as amended by this Act.

Income Tax Law, approved September 8, 1916.

Amendments approved, March 3, 1917, and October 3, 1917.

APPENDIX B

WAR REVENUE LAW

ENACTED OCTOBER 3, 1917

TITLE I.—WAR INCOME TAX

SECTION 1. That in addition to the normal tax imposed by subdivision (a) of section one of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid a like normal tax of two per centum upon the income of every individual, a citizen or resident of the United States, received in the calendar year nineteen hundred and seventeen and every calendar year thereafter. **Individuals. Normal Tax.**

SEC. 2. That in addition to the additional tax imposed by subdivision (b) of section one of such Act of September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid a like additional tax upon the income of every individual received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, as follows: **Additional Tax.**

One per centum per annum upon the amount by which the total net income exceeds $5,000 and does not exceed $7,500;

Two per centum per annum upon the amount by which the total net income exceeds $7,500 and does not exceed $10,000;

Three per centum per annum upon the amount by which the total net income exceeds $10,000 and does not exceed $12,500;

Four per centum per annum upon the amount by which the total net income exceeds $12,500 and does not exceed $15,000;

Five per centum per annum upon the amount by which the total net income exceeds $15,000 and does not exceed $20,000;

Seven per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $40,000;

Ten per centum per annum upon the amount by which the total net income exceeds $40,000 and does not exceed $60,000;

Fourteen per centum per annum upon the amount by which the total net income exceeds $60,000 and does not exceed $80,000;

Eighteen per centum per annum upon the amount by which the total net income exceeds $80,000 and does not exceed $100,000;

Twenty-two per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $150,000;

Twenty-five per centum per annum upon the amount by which the total net income exceeds $150,000 and does not exceed $200,000;

Thirty per centum per annum upon the amount by which the total net income exceeds $200,000 and does not exceed $250,000;

Thirty-four per centum per annum upon the amount by which the total net income exceeds $250,000 and does not exceed $300,000.

Thirty-seven per centum per annum upon the amount by which the total net income exceeds $300,000 and does not exceed $500,000;

Forty per centum per annum upon the amount by which the total net income exceeds $500,000 and does not exceed $750,000.

Forty-five per centum per annum upon the amount by which the total net income exceeds $750,000 and does not exceed $1,000,000.

Fifty per centum per annum upon the amount by which the total net income exceeds $1,000,000.

SEC. 3. That the taxes imposed by sections one and two of this Act shall be computed, levied, assessed, collected, and paid upon the same basis and in the same manner as the similar taxes imposed by section one of such Act of September eighth, nineteen hundred and sixteen, except that in the case of the tax imposed by section one of this Act (a) the exemptions of $3,000 and $4,000 provided in section seven of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, shall be, respectively, $1,000 and $2,000, and (b) the returns required under subdivisions (b) and (c) of section eight of such Act as amended by this Act shall be required in the case of net incomes of $1,000 or over, in the case of unmarried persons, and $2,000 or over in the case of married persons, instead of $3,000 or over, as therein provided, and (c) the provisions of subdivision (c) of section nine of such Act, as amended by this Act, requiring the normal tax of individuals on income derived from interest to be deducted and withheld at the source of the income shall not apply to the new two per centum normal tax prescribed in section one of this Act until on and after January first, nineteen hundred and eighteen, and thereafter only one two per centum normal tax shall be deducted and withheld at the source under the provisions of such subdivision (c), and any further normal tax for which the recipient of such income is liable under this Act or such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, shall be paid by such recipient.

Basis of Computation same as under Act of 1916.

Exemptions Returns.

Withholding How Applied.

SEC. 4. That in addition to the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, there shall be levied, assessed, collected, and paid a like tax of four per centum upon the income received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, by every corporation, joint-stock company or association, or insurance company, subject to the tax imposed by that subdivision of that section, except that if it has fixed its own fiscal year, the tax imposed by this section for the fiscal year ending during the calendar year nineteen hundred and seventeen shall be levied, assessed, collected, and paid only on that proportion of its income for such fiscal year which the period between January first, nineteen hundred and

Corporations Rate.

Fiscal Year.

seventeen, and the end of such fiscal year bears to the whole of such fiscal year.

The tax imposed by this section shall be computed, levied, assessed, collected, and paid upon the same incomes and in the same manner as the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, except that for the purpose of the tax imposed by this section the income embraced in a return of a corporation, joint-stock company or association, or insurance company, shall be credited with the amount received as dividends upon the stock or from the net earnings of any other corporation, joint-stock company or association, or insurance company, which is taxable upon its net income as provided in this title. **Basis of Computation.**

SEC. 5. That the provisions of this title shall not extend to Porto Rico or the Philippine Islands, and the Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively. **Not Applicable to Porto Rico and Philippines.**

TITLE II.—WAR EXCESS PROFITS TAX

SEC. 200. That when used in this title—

The term "corporation" includes joint-stock companies or associations and insurance companies; **"Corporation."**

The term "domestic" means created under the law of the United States, or of any State, Territory, or District thereof, and the term "foreign" means created under the law of any other possession of the United States or of any foreign country or government; **"Domestic." "United States."**

The term "United States" means only the States, the Territories of Alaska and Hawaii, and the District of Columbia; **"Foreign."**

The term "taxable year" means the twelve months ending December thirty-first, excepting in the case of a corporation or partnership which has fixed its own fiscal year, in which case it means such fiscal year. The first taxable year shall be the year ending December thirty-first, nineteen hundred and seventeen, except that in the case of a corporation or partnership which has fixed its own fiscal year, it shall be the fiscal year ending during the calendar year nineteen hundred and seventeen. If a corporation or partnership, prior to March first, nineteen hundred and eighteen, makes a return covering its own fiscal year, and includes therein the income received during that part of the fiscal year falling within the calendar year nineteen hundred and sixteen, the tax for such taxable year shall be that proportion of the tax computed upon the net income during such full fiscal year which the time from January first, nineteen hundred and seventeen, to the end of such fiscal year bears to the full fiscal year; and **"Taxable Year."**

The term "prewar period" means the calendar years nineteen hundred and eleven, nineteen hundred and twelve, and nineteen hundred and thirteen, or, if a corporation or partnership was not in existence or an individual was not engaged in a trade or business during the **"Prewar Period."**

whole of such period, then as many of such years during the whole of which the corporation or partnership was in existence of the individual was engaged in the trade or business.

"Trade" and "Business." The terms "trade" and "business" include professions and occupations.

"Net Income." The term "net income" means in the case of a foreign corporation or partnership or a nonresident alien individual, the net income received from sources within the United States.

SEC. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income:

Additional Taxes. Rates.

Twenty per centum of the amount of the net income in excess of the deduction (determined as hereinafter provided) and not in excess of fifteen per centum of the invested capital for the taxable year;

Twenty-five per centum of the amount of the net income in excess of fifteen per centum and not in excess of twenty per centum of such capital;

Thirty-five per centum of the amount of the net income in excess of twenty per centum and not in excess of twenty-five per centum of such capital;

Forty-five per centum of the amount of the net income in excess of twenty-five per centum and not in excess of thirty-three per centum of such capital; and

Sixty per centum of the amount of the net income in excess of thirty-three per centum of such capital.

For the purpose of this title every corporation or partnership not exempt under the provisions of this section shall be deemed to be engaged in business, and all the trades and businesses in which it is engaged shall be treated as a single trade or business, and all its income from whatever source derived shall be deemed to be received from such trade or business.

This title shall apply to all trades or businesses of whatever description, whether continuously carried on or not, except—

Incomes Exempt.

(a) In the case of officers and employees under the United States, or any State, Territory, or the District of Columbia, or any local subdivision thereof, the compensation or fees received by them as such officers or employees;

(b) Corporations exempt from tax under the provisions of section eleven of Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, and partnerships and individuals carrying on or doing the same business, or coming within the same description; and

(c) Incomes derived from the business of life, health, and accident insurance combined in one policy issued on the weekly premium payment plan.

SEC. 202. That the tax shall not be imposed in the case of the trade or business of a foreign corporation or partnership or a nonresident alien individual, the net income of which trade or business during the taxable year is less than $3,000.

Deductions. SEC. 203. That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided—

(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $3,000; Domestic Corporation.

(b) In the case of a domestic partnership or of a citizen or resident of the United States, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $6,000; Domestic Partnership. Citizen or Resident.

(c) In the case of a foreign corporation or partnership or of a nonresident alien individual, an amount ascertained in the same manner as provided in subdivisions (a) and (b) without any exemption of $3,000 or $6,000. Foreign Corporation or Partnership.

(d) If the Secretary of the Treasury is unable satisfactorily to determine the average amount of the annual net income of the trade or business during the prewar period, the deduction shall be determined in the same manner as provided in section two hundred and five. When Prewar Income not Determinable.

SEC. 204. That if a corporation or partnership was not in existence, or an individual was not engaged in the trade or business, during the whole of any one calendar year during the prewar period, the deduction shall be an amount equal to eight per centum of the invested capital for the taxable year, plus in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000. Not in Business During Prewar Period.

A trade or business carried on by a corporation, partnership, or individual, although formally organized or reorganized on or after January second, nineteen hundred and thirteen, which is substantially a continuation of a trade or business carried on prior to that date, shall, for the purposes of this title, be deemed to have been in existence prior to that date, and the net income and invested capital of its predecessor prior to that date shall be deemed to have been its net income and invested capital. Continuation of Old Business.

SEC. 205. (a) That if the Secretary of the Treasury, upon complaint finds either (1) that during the prewar period a domestic corporation or partnership, or a citizen or resident of the United States, had no net income from the trade or business, or (2) that during the prewar period the percentage, which the net income was of the invested capital, was low as compared with the percentage, which the net income during such period of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, was of their invested capital, then the deduction shall be the sum of (1) an amount equal to the Comparatively Low Net Income During Prewar Period—Complaint.

same percentage of its invested capital for the taxable year which the average deduction (determined in the same manner as provided in section two hundred and three, without including the $3,000 or $6,000 therein referred to) for such year of representative corporations, partnerships, or individuals, engaged in a like or similar trade or business, is of their average invested capital for such year plus (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000.

Percentage Net Income to Invested Capital Determined by Department.

The percentage which the net income was of the invested capital in each trade or business shall be determined by the Commissioner of Internal Revenue, in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury. In the case of a corporation or partnership which has fixed its own fiscal year, the percentage determined by the calendar year ending during such fiscal year shall be used.

(b) The tax shall be assessed upon the basis of the deduction determined as provided in section two hundred and three, but the taxpayer claiming the benefit of this section may at the time of making the return file a claim for abatement of the amount by which the tax so assessed exceeds a tax computed upon the basis of the deduction determined as provided in this section. In such event, collection of the part of the tax covered by such claim for abatement shall not be made until the claim is decided, but if in the judgment of the Commissioner of Internal Revenue, the interests of the United States would be jeopardized thereby he may require the claimant to give a bond in such amount and with such sureties as the commissioner may think wise to safeguard such interests, conditioned for the payment of any tax found to be due, with the interest thereon, and if such bond, satisfactory to the commissioner, is not given within such time as he prescribes, the full amount of tax assessed shall be collected and the amount overpaid, if any, shall upon final decision of the application be refunded as a tax erroneously or illegally collected.

Claim for Abatement.

SEC. 206. That for the purposes of this title the net income of a corporation shall be ascertained and returned (a) for the calendar years nineteen hundred and eleven and nineteen hundred and twelve upon the same basis and in the same manner as provided in section thirty-eight of the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August fifth, nineteen hundred and nine, except that income taxes paid by it within the year imposed by the authority of the United States shall be included; (b) for the calendar year nineteen hundred and thirteen upon the same basis and in the same manner as provided in section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October third, nineteen hundred and thirteen, except that income taxes paid by it within the year imposed by the authority of the United States shall be in-

Net Income of Corporation, How Determined 1911, 1912, 1913.

cluded, and except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by section II of such Act of October third, nineteen hundred and thirteen, shall be deducted; and (c) for the taxable year upon the same basis and in the same manner as provided in Title I of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended by this Act, except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by Title I of such Act of September eighth, nineteen hundred and sixteen, shall be deducted.

For Taxable Year.

The net income of a partnership or individual shall be ascertained and returned for the calendar years nineteen hundred and eleven, nineteen hundred and twelve, and nineteen hundred and thirteen, and for the taxable year, upon the same basis and in the same manner as provided in Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, except that the credit allowed by subdivision (b) of section five of such Act shall be deducted. There shall be allowed (a) in the case of a domestic partnership the same deductions as allowed to individuals in subdivision (a) of section five of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act; and (b) in the case of a foreign partnership the same deductions as allowed to individuals in subdivision (a) of section six of such Act as amended by this Act.

Net Income of Partnership or Individual, How Determined.

SEC. 207. That as used in this title, the term "invested capital" for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

Invested Capital Defined.

As used in this title "invested capital" does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title nor money or other property borrowed, and means, subject to the above limitations:

(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: *Provided*, That (a) the actual cash value of patents and copyrights paid in for stock or shares in such corporation or partnership, at the time of such payment, shall be included as invested capital, but not

Corporation or Partnership.

Patents.

to exceed the par value of such stock or shares at the time of such payment,

Good Will. and (b) the good will, trade-marks, trade brands, the franchise of a corporation or partnership, or other intangible property, shall be included as invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash or tangible property, the value of such good will, trade-mark, trade brand, franchise, or intangible property, not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment; but good will, trade-marks, trade brands, franchise of a corporation or partnership, or other intangible property, bona fide purchased, prior to March third, nineteen hundred and seventeen, for and with interests or shares in a partnership or for and with shares in the capital stock of a corporation (issued prior to

Limited Proportion of Capital Stock. March third, nineteen hundred and seventeen), in an amount not to exceed, on March third, nineteen hundred and seventeen, twenty per centum of the total interests or shares in the partnership or of the total shares of the capital stock of the corporation, shall be included in invested capital at a value not to exceed the actual cash value at the time of such purchase, and in case of issue of stock therefor not to exceed the par value of such stock;

(b) In the case of an individual, (1) actual cash paid into the trade or business, and (2) the actual cash value of tangible property paid into the

Individual. trade or business, other than cash, at the time of such payment (but in case such tangible property was paid in prior to January first, nineteen hundred and fourteen, the actual cash value of such property as of January first, nineteen hundred and fourteen), and (3)

Patents, Good Will. the actual cash value of patents, copyrights, good will, trade-marks, trade brands, franchises, or other intangible property, paid into the trade or business, at the time of such payment, if payment was made therefor specifically as such in cash or tangible property, not to exceed the actual cash or actual cash value of the tangible property bona fide paid therefor at the time of such payment.

Foreign Corporation—Partnership Nonresident Alien. In the case of a foreign corporation or partnership or of a nonresident alien individual the term "invested capital" means that proportion of the entire invested capital, as defined and limited in this title, which the net income from sources within the United States bears to the entire net income.

SEC. 208. That in case of the reorganization, consolidation or change of ownership of a trade or business after March third, nineteen hundred and

Reorganization. seventeen, if an interest or control in such trade or business of fifty per centum or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or

Invested Capital. received from the prior trade or business shall be allowed a greater value than would have been allowed under this title in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the

actual cash or actual cash value of the tangible property paid therefor at the time of such payment.

SEC. 209. That in the case of a trade or business having no invested capital or not more than a nominal capital there shall be levied, assessed, collected and paid, in addition to the taxes under existing law and under this Act, in lieu of the tax imposed by section two hundred and one, a tax equivalent to eight per centum of the net income of such trade or business in excess of the following deductions: In the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000; in the case of all other trades or business, no deduction. **Nominal or no Capital.**

SEC. 210. That if the Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital, the amount of the deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction (determined in the same manner as provided in section two hundred and three, without including the $3,000 or $6,000 therein referred to) for the same calendar year of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, bears to the total net income of the trade or business received by such corporations, partnerships, and individuals, plus (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000. **Where Invested Capital is not Determinable.**

For the purpose of this section the proportion between the deduction and the net income in each trade or business shall be determined by the Commissioner of Internal Revenue in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury. In the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used. **Proportion of Deduction and Net Income Determined by Department.**

SEC. 211. That every foreign partnership having a net income of $3,000 or more for the taxable year, and every domestic partnership having a net income of $6,000 or more for the taxable year, shall render a correct return of the income of the trade or business for the taxable year, setting forth specifically the gross income for such year, and the deductions allowed in this title. Such returns shall be rendered at the same time and in the same manner as is prescribed for income tax returns under Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act. **Partnership Returns.**

SEC. 212. That all administrative, special, and general provisions of law, including the laws in relation to the assessment, remission, collection, and refund of internal-revenue taxes not heretofore specifically repealed, and not inconsistent with the provisions of this title are hereby extended and made applicable to all the provisions of this title and to the tax herein imposed, and all provisions of Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by **Administrative Provisions.**

this Act, relating to returns and payment of the tax therein imposed, including penalties, are hereby made applicable to the tax imposed by this title.

SEC. 213. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make all necessary regulations for carrying out the provisions of this title, and may require any corporation, partnership, or individual, subject to the provisions of this title, to furnish him with such facts, data, and information as in his judgment are necessary to collect the tax imposed by this title.

Regulations.

SEC. 214. That Title II (sections two hundred to two hundred and seven, inclusive) of the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy, and the extensions of fortifications, and for other purposes," approved March third, nineteen hundred and seventeen, is hereby repealed.

Repeal of Old Excess Profits Tax Law.

Any amount heretofore or hereafter paid on account of the tax imposed by such Title II, shall be credited toward the payment of the tax imposed by this title, and if the amount so paid exceeds the amount of such tax the excess shall be refunded as a tax erroneously or illegally collected.

Application of Payments Made.

Subdivision (1) of section three hundred and one of such Act of September eighth, nineteen hundred and sixteen, is hereby amended so that the rate of tax for the taxable year nineteen hundred and seventeen shall be ten per centum instead of twelve and one-half per centum, as therein provided.

Munitions Tax Reduced to 10%

Subdivision (2) of such section is hereby amended to read as follows: "(2) This section shall cease to be of effect on and after January first, nineteen hundred and eighteen."

TITLE III.—WAR TAX ON BEVERAGES

SEC. 300. That on and after the passage of this Act there shall be levied and collected on all distilled spirits in bond at that time or that have been or that may be then or thereafter produced in or imported into the United States, except such distilled spirits as are subject to the tax provided in section three hundred and three, in addition to the tax now imposed by law, a tax of $1.10 (or, if withdrawn for beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage, a tax of $2.10) on each proof gallon, or wine gallon when below proof, and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn, and collected under the provisions of existing law.

Distilled Spirits.

Rate of Tax.

That in addition to the tax under existing law there shall be levied and collected upon all perfumes hereafter imported into the United States containing distilled spirits, a tax of $1.10 per wine gallon, and a proportionate tax at a like rate on all fractional parts of such wine gallon. Such tax shall be collected by the collector of customs and deposited as internal-revenue collections, under

Perfumes Containing Distilled Spirits.

such rules and regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe.

SEC. 301. That no distilled spirits produced after the passage of this Act shall be imported into the United States from any foreign country, or from the West Indian Islands recently acquired from Denmark (unless produced from products the growth of such islands, and not then into any State or Territory or District of the United States in which the manufacture or sale of intoxicating liquor is prohibited), or from Porto Rico, or the Philippine Islands. Under such rules, regulations, and bonds as the Secretary of the Treasury may prescribe, the provisions of this section shall not apply to distilled spirits imported for other than (1) beverage purposes or (2) use in the manufacture or production of any article used or intended for use as a beverage.

Importation Prohibited.

Exception.

SEC. 302. That at registered distilleries producing alcohol, or other high-proof spirits, packages may be filled with such spirits reduced to not less than one hundred proof from the receiving cisterns and tax paid without being entered into bonded warehouse. Such spirits may be also transferred from the receiving cisterns at such distilleries, by means of pipe lines, direct to storage tanks in the bonded warehouse and may be warehoused in such storage tanks. Such spirits may be also transferred in tanks or tank cars to general bonded warehouses for storage therein, either in storage tanks in such warehouses or in the tanks in which they were transferred. Such spirits may also be transferred after tax payment from receiving cisterns or warehouse storage tanks to tanks or tank cars and may be transported in such tanks or tank cars to the premises of rectifiers of spirits. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby empowered to prescribe all necessary regulations relating to the drawing off, transferring, gauging, storing and transporting of such spirits; the records to be kept and returns to be made; the size and kind of packages and tanks to be used; the marking, branding, numbering and stamping of such packages and tanks; the kinds of stamps, if any, to be used; and the time and manner of paying the tax; the kind of bond and the penal sum of same. The tax prescribed by law must be paid before such spirits are removed from the distillery premises, or from general bonded warehouse in the case of spirits transferred thereto, except as otherwise provided by law.

Bonded Warehouses. Transfers.

Regulations for Drawing, etc.

When Tax Payable.

Under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, distilled spirits may hereafter be drawn from receiving cisterns and deposited in distillery warehouses without having affixed to the packages containing the same distillery warehouse stamps, and such packages, when so deposited in warehouse, may be withdrawn therefrom on the original gauge where the same have remained in such warehouse for a period not exceeding thirty days from the date of deposit.

Ethyl and Denatured Alcohol.

Under such regulations as the Commissioner of Internal Revenue, with

the approval of the Secretary of the Treasury, may prescribe, the manufacture, warehousing, withdrawal, and shipment, under the provisions of existing law, of ethyl alcohol for other than (1) beverage purposes or (2) use in the manufacture or production of any article used or intended for use as a beverage, and denatured alcohol, may be exempted from the provisions of section thirty-two hundred and eighty-three, Revised Statutes of the United States.

Regulations Ethyl Alcohol Manufacture.

Under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, manufacturers of ethyl alcohol for other than beverage purposes may be granted permission under the provisions of section thirty-two hundred and eighty-five, Revised Statutes of the United States, to fill fermenting tub in a sweet-mash distillery not oftener than once in forty-eight hours.

SEC. 303. That upon all distilled spirits produced in or imported into the United States upon which the tax now imposed by law has been paid, and which, on the day this Act is passed, are held by a retailer in a quantity in excess of fifty gallons in the aggregate, or by any other person, corporation, partnership, or association in any quantity, and which are intended for sale, there shall be levied, assessed, collected, and paid a tax of $1.10 (or, if intended for sale for beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage, a tax of $2.10) on each proof gallon, and a proportionate tax at a like rate on all fractional parts of such proof gallon: *Provided*, That the tax on such distilled spirits in the custody of a court of bankruptcy in insolvency proceedings on June first, nineteen hundred and seventeen, shall be paid by the person to whom the court delivers such distilled spirits at the time of such delivery, to the extent that the amount thus delivered exceeds the fifty gallons hereinbefore provided.

Tax on Stock Distilled Spirits.

Rate of Tax.

SEC. 304. That in addition to the tax now imposed or imposed by this Act on distilled spirits there shall be levied, assessed, collected, and paid a tax of 15 cents on each proof gallon and a proportionate tax at a like rate on all fractional parts of such proof gallon on all distilled spirits or wines hereafter rectified, purified, or refined in such manner, and on all mixtures hereafter produced in such manner, that the person so rectifying, purifying, refining, or mixing the same is a rectifier within the meaning of section thirty-two hundred and forty-four, Revised Statutes, as amended, and on all such articles in the possession of the rectifier on the day this Act is passed: *Provided*, That this tax shall not apply to gin produced by the redistillation of a pure spirit over juniper berries and other aromatics.

Additional Tax.

Gin.

When the process of rectification is completed and the tax prescribed by this section has been paid, it shall be unlawful for the rectifier or other dealer to reduce in proof or increase in volume such spirits or wine by the addition of water or other substance; nothing herein contained shall, however, prevent a rectifier from using again in the process of rectification spirits already rectified and upon which the tax has theretofore been paid.

Diluting Prohibited.

The tax imposed by this section shall not attach to cordials or liqueurs on which a tax is imposed and paid under the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, nor to the mixing and blending of wines, where such blending is for the sole purpose of perfecting such wines according to commercial standards, nor to blends made exclusively of two or more pure straight whiskies aged in wood for a period not less than four years and without the addition of coloring or flavoring matter or any other substance than pure water and if not reduced below ninety proof: *Provided*, That such blended whiskies shall be exempt from tax under this section only when compounded under the immediate supervision of a revenue officer, in such tanks and under such conditions and supervision as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe.

Cordials, Liqueurs not Affected.

Blended Whiskies.

All distilled spirits taxable under this section shall be subject to uniform regulations concerning the use thereof in the manufacture, blending, compounding, mixing, marking, branding, and sale of whisky and rectified spirits, and no discrimination whatsoever shall be made by reason of a difference in the character of the material from which same may have been produced.

Uniform Regulations.

The business of a rectifier of spirits shall be carried on, and the tax on rectified spirits shall be paid, under such rules, regulations, and bonds as may be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury.

Rectifiers.

Any person violating any of the provisions of this section shall be deemed to be guilty of a misdemeanor and, upon conviction, shall be fined not more than $1,000 or imprisoned not more than two years. He shall, in addition, be liable to double the tax evaded together with the tax, to be collected by assessment or on any bond given.

Penalty for Violations.

SEC. 305. That hereafter collectors of internal revenue shall not furnish wholesale liquor dealer's stamps in lieu of and in exchange for stamps for rectified spirits unless the package covered by stamp for rectified spirits is to be broken into smaller packages.

Stamps Exchanged.

The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is authorized to discontinue the use of the following stamps whenever in his judgment the interests of the Government will be subserved thereby:

Stamps may be Discontinued.

Distillery warehouse, special bonded warehouse, special bonded rewarehouse, general bonded warehouse, general bonded retransfer, transfer brandy, export tobacco, export cigars, export oleomargarine and export fermented liquor stamps.

SEC. 306. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to require at distilleries, breweries, rectifying houses, and wherever else in his judgment such action may be deemed advisable, the installation of meters, tanks, pipes, or any other apparatus for the purpose of pro-

Apparatus.

tecting the revenue, and such meters, tanks, and pipes and all necessary labor incident thereto shall be at the expense of the person, corporation, partnership, or association on whose premises the installation is required. Any such person, corporation, partnership, or association refusing or neglecting to install such apparatus when so required by the commissioner shall not be permitted to conduct business on such premises.

SEC. 307. That on and after the passage of this Act there shall be levied, and collected on all beer, larger beer, ale, porter, and other similar fermented liquor, containing one-half per centum or more of alcohol, brewed or manufactured and sold, or stored in warehouse, or removed for consumption or sale, within the United States, by whatever name such liquors may be called, in addition to the tax now imposed by law, a tax of $1.50 for every barrel containing not more than thirty-one gallons, and at a like rate for any other quantity or for the fractional parts of a barrel authorized and defined by law.

Beer, Ale, etc.

SEC. 308. That from and after the passage of this Act taxable fermented liquors may be conveyed without payment of tax from the brewery premises where produced to a contiguous industrial distillery of either class established under the Act of October third, nineteen hundred and thirteen, to be used as distilling material, and the residue from such distillation, containing less than one-half of one per centum of alcohol by volume, which is to be used in making beverages, may be manipulated by cooling, flavoring, carbonating, settling, and filtering on the distillery premises or elsewhere.

Fermented Liquors Conveyed.

The removal of the taxable fermented liquor from the brewery to the distillery and the operation of the distillery and removal of the residue therefrom shall be under the supervision of such officer or officers as the Commissioner of Internal Revenue shall deem proper, and the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to make such regulations from time to time as may be necessary to give force and effect to this section and to safeguard the revenue.

Removal of Liquor.

SEC. 309. That upon all still wines, including vermuth, and upon all champagne and other sparkling wines, liqueurs, cordials, artificial or imitation wines or compounds sold as wine, produced in or imported into the United States, and hereafter removed from the custom-house, place of manufacture, or from bonded premises for sale or consumption, there shall be levied and collected, in addition to the tax now imposed by law upon such articles, a tax equal to such tax, to be levied, collected, and paid under the provisions of existing law.

Still Wines, etc.

SEC. 310. That upon all articles specified in section three hundred and nine upon which the tax now imposed by law has been paid and which are on the day this Act is passed held in excess of twenty-five gallons in the aggregate of such articles and intended for sale, there shall be levied, collected, and paid a tax equal to the tax imposed by such section.

Excess Stock Taxable.

SEC. 311. That upon all grape brandy or wine spirits withdrawn by a producer of wines from any fruit distillery or special bonded warehouse

under subdivision (c) of section four hundred and two of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, there shall be levied, assessed, collected, and paid in addition to the tax therein imposed, a tax equal to double such tax, to be assessed, collected, and paid under the provisions of existing law. **Grape Brandy, etc.**

SEC. 312. That upon all sweet wines held for sale by the producer thereof upon the day this Act is passed there shall be levied, assessed, collected, and paid an additional tax equivalent to 10 cents per proof gallon upon the grape brandy or wine spirits used in the fortification of such wine, and an additional tax of 20 cents per proof gallon shall be levied, assessed, collected, and paid upon all grape brandy or wine spirits withdrawn by a producer of sweet wines for the purpose of fortifying such wines and not so used prior to the passage of this Act. **Sweet Wine.**

SEC. 313. That there shall be levied, assessed, collected, and paid—

(a) Upon all prepared sirups or extracts (intended for use in the manufacture or production of beverages, commonly known as soft drinks, by soda fountains, bottling establishments, and other similar places) sold by the manufacturer, producer, or importer thereof, if so sold for not more than $1.30 per gallon, a tax of 5 cents per gallon; if so sold for more than $1.30 and not more than $2 per gallon, a tax of 8 cents per gallon; if so sold for more than $2 and not more than $3 per gallon, a tax of 10 cents per gallon; if so sold for more than $3 and not more than $4 per gallon, a tax of 15 cents per gallon; and if so sold for more than $4 per gallon, a tax of 20 cents per gallon; and **Sirups, Extracts.**

(b) Upon all unfermented grape juice, soft drinks, or artificial mineral waters (not carbonated), and fermented liquors containing less than one-half per centum of alcohol, sold by the manufacturer, producer, or importer thereof, in bottles or other closed containers and upon all ginger ale, root beer, sarsaparilla, pop, and other carbonated waters or beverages, manufactured and sold by the manufacturer, producer, or importer of the carbonic acid gas used in carbonating the same, a tax of 1 cent per gallon; and **Soft Drinks.**

(c) Upon all natural mineral waters or table waters, sold by the producer, bottler, or importer thereof, in bottles or other closed containers, at over 10 cents per gallon, a tax of 1 cent per gallon. **Waters.**

SEC. 314. That each such manufacturer, producer, bottler, or importer shall make monthly returns under oath to the collector of internal revenue for the district in which is located the principal place of business, containing such information necessary for the assessment of the tax, and at such times and in such manner, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe. **Returns.**

SEC. 315. That upon all carbonic acid gas in drums or other containers (intended for use in the manufacture or production of carbonated water or other drinks) sold by the manufacturer, producer, or importer thereof, there shall be levied, assessed, collected, and paid a tax of 5 cents per pound. Such tax shall be paid by **Carbonic Acid Gas Tax.**

the purchaser to the vendor thereof and shall be collected, returned, and paid to the United States by such vendor in the same manner as provided in section five hundred and three.

TITLE IV.—WAR TAX ON CIGARS, TOBACCO, AND MANUFACTURES THEREOF

SEC. 400. That upon cigars and cigarettes, which shall be manufactured and sold, or removed for consumption or sale, there shall be levied and collected, in addition to the taxes now imposed by existing law, the following taxes, to be paid by the manufacturer or importer thereof: (a) on cigars of all descriptions made of tobacco, or any substitute therefor, and weighing not more than three pounds per thousand, 25 cents per thousand; (b) on cigars made of tobacco, or any substitute therefor, and weighing more than three pounds per thousand, if manufactured or imported to retail at 4 cents or more each, and not more than 7 cents each, $1 per thousand; (c) if manufactured or imported to retail at more than 7 cents each and not more than 15 cents each, $3 per thousand; (d) if manufactured or imported to retail at more than 15 cents each and not more than 20 cents each, $5 per thousand; (e) if manufactured or imported to retail at more than 20 cents each, $7 per thousand: *Provided*, That the word "retail" as used in this section shall mean the ordinary retail price of a single cigar, and that the Commissioner of Internal Revenue may, by regulation, require the manufacturer or importer to affix to each box or container a conspicuous label indicating by letter the clause of this section under which the cigars therein contained have been tax-paid, which must correspond with the tax-paid stamp on said box or container; (f) on cigarettes made of tobacco, or any substitute therefor, made in or imported into the United States, and weighing not more than three pounds per thousand, 80 cents per thousand; weighing more than three pounds per thousand, $1.20 per thousand.

Cigars and Cigarettes.

Rates of Taxes.

"Retail" Defined.

Cigarettes Tax.

Every manufacturer of cigarettes (including small cigars weighing not more than three pounds per thousand) shall put up all the cigarettes and such small cigars that he manufactures or has manufactured for him, and sells or removes for consumption or use, in packages or parcels containing five, eight, ten, twelve, fifteen, sixteen, twenty, twenty-four, forty, fifty, eighty, or one hundred cigarettes each, and shall securely affix to each of said packages or parcels a suitable stamp denoting the tax thereon and shall properly cancel the same prior to such sale or removal for consumption or use under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and all cigarettes imported from a foreign country shall be packed, stamped, and the stamps canceled in a like manner, in addition to the import stamp indicating inspection of the custom-house before they are withdrawn therefrom.

Packages of Cigarettes.

Use of Stamps.

Imported Cigarettes.

SEC. 401. That upon all tobacco and snuff hereafter manufactured and

sold, or removed for consumption or use, there shall be levied and collected, in addition to the tax now imposed by law upon such articles, a tax of 5 cents per pound, to be levied, collected, and paid under the provisions of existing law. **Tobacco and Snuff Tax.**

In addition to the packages provided for under existing law, manufactured tobacco and snuff may be put up and prepared by the manufacturer for sale or consumption, in packages of the following description: Packages containing one-eighth, three-eighths, five-eighths, seven-eighths, one and one-eighth, one and three-eighths, one and five-eighths, one and seven-eighths, and five ounces. **Additional Packages.**

SEC. 402. That sections four hundred, four hundred and one, and four hundred and four, shall take effect thirty days after the passage of this Act: *Provided*, That after the passage of this Act and before the expiration of the aforesaid thirty days, cigarettes and manufactured tobacco and snuff may be put up in the packages now provided for by law or in the packages provided for in sections four hundred and four hundred and one. **When Effective.**

SEC. 403. That there shall also be levied and collected, upon all manufactured tobacco and snuff in excess of one hundred pounds or upon cigars or cigarettes in excess of one thousand, which were manufactured or imported, and removed from factory or custom-house prior to the passage of this Act, bearing tax-paid stamps affixed to such articles for the payment of the taxes thereon, and which are, on the day after this Act is passed, held and intended for sale by any person, corporation, partnership, or association, and upon all manufactured tobacco, snuff, cigars, or cigarettes, removed from factory or customs house after the passage of this Act but prior to the time when the tax imposed by section four hundred or section four hundred and one upon such articles takes effect, an additional tax equal to one-half the tax imposed by such sections upon such articles. **Excess Quantity. Rate of Tax.**

SEC. 404. That there shall be levied, assessed, and collected upon cigarette paper made up into packages, books, sets, or tubes, made up in or imported into the United States and intended for use by the smoker in making cigarettes the following taxes: On each package, book, or set, containing more than twenty-five but not more than fifty papers, one-half of 1 cent; containing more than fifty but not more than one hundred papers, 1 cent; containing more than one hundred papers, 1 cent for each one hundred papers or fractional part thereof; and upon tubes, 2 cents for each one hundred tubes or fractional part thereof. **Cigarette Paper, etc. Rate of Tax.**

TITLE V.—WAR TAX ON FACILITIES FURNISHED BY PUBLIC UTILITIES, AND INSURANCE

SEC. 500. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid (a) a tax equivalent to three per centum of the amount paid for the transportation by rail or water or by any form of **Transportation**

mechanical motor power when in competition with carriers by rail or water of property by freight consigned from one point in the United States to another; (b) a tax of 1 cent for each 20 cents, or fraction thereof, paid to any person, corporation, partnership, or association, engaged in the business of transporting parcels or packages by express over regular routes between fixed terminals, for the transportation of any package, parcel, or shipment by express from one point in the United States to another: *Provided*, That nothing herein contained shall be construed to require the carrier collecting such tax to list separately in any bill of lading, freight receipt, or other similar document, the amount of the tax herein levied, if the total amount of the freight and tax be therein stated; (c) a tax equivalent to eight per centum of the amount paid for the transportation of persons by rail or water, or by any form of mechanical motor power on a regular established line when in competition with carriers by rail or water, from one point in the United States to another or to any point in Canada or Mexico, where the ticket therefor is sold or issued in the United States, not including the amount paid for commutation or season tickets for trips less than thirty miles, or for transportation the fare for which does not exceed 35 cents, and a tax equivalent to ten per centum of the amount paid for seats, berths, and staterooms in parlor cars, sleeping cars, or on vessels. If a mileage book used for such transportation or accommodation has been purchased before this section takes effect, or if cash fare be paid, the tax imposed by this section shall be collected from the person presenting the mileage book, or paying the cash fare, by the conductor or other agent, when presented for such transportation or accommodation, and the amount so collected shall be paid to the United States in such manner and at such times as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe; if a ticket (other than a mileage book) is bought and partially used before this section goes into effect it shall not be taxed, but if bought but not so used before this section takes effect, it shall not be valid for passage until the tax has been paid and such payment evidenced on the ticket in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe; (d) a tax equivalent to five per centum of the amount paid for the transportation of oil by pipe line; (e) a tax of 5 cents upon each telegraph, telephone, or radio, dispatch, message, or conversation, which originates within the United States, and for the transmission of which a charge of 15 cents or more is imposed: *Provided*, That only one payment of such tax shall be required, notwithstanding the lines or stations of one or more persons, corporations, partnerships, or associations shall be used for the transmission of such dispatch, message, or conversation.

Freight. **Rate of Tax.** **Express-age.** **Rate of Tax.** **Passengers, Rate of Tax.** **Mileage.** **Pipe Line Rate.**

SEC. 501. That the taxes imposed by section five hundred shall be paid by the person, corporation, partnership, or association paying for the services or facilities rendered.

Who Pays Tax.

In case such carrier does not, because of its ownership of the commodity

transported, or for any other reason, receive the amount which as a carrier it would otherwise charge, such carrier shall pay a tax equivalent to the tax which would be imposed upon the transportation of such commodity if the carrier received payment for such transportation: *Provided*, That in case of a carrier which on May first, nineteen hundred and seventeen, had no rates or tariffs on file with the proper Federal or State authority, the tax shall be computed on the basis of the rates or tariffs of other carriers for like services as ascertained and determined by the Commissioner of Internal Revenue: *Provided further*, That nothing in this or the preceding section shall be construed as imposing a tax (a) upon the transportation of any commodity which is necessary for the use of the carrier in the conduct of its business as such and is intended to be so used or has been so used; or (b) upon the transportation of company material transported by one carrier, which constitutes a part of a railroad system, for another carrier which is also a part of the same system.

Ownership of Commodities.

Tariffs.

When Tax not Applicable.

SEC. 502. That no tax shall be imposed under section five hundred upon any payment received for services rendered to the United States, or any State, Territory, or the District of Columbia. The right to exemption under this section shall be evidenced in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

Exemption.

SEC. 503. That each person, corporation, partnership, or association receiving any payments referred to in section five hundred shall collect the amount of the tax, if any, imposed by such section from the person, corporation, partnership, or association making such payments, and shall make monthly returns under oath, in duplicate, and pay the taxes so collected and the taxes imposed upon it under paragraph two of section five hundred and one to the collector of internal revenue of the district in which the principal office or place of business is located. Such returns shall contain such information, and be made in such manner, as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

Monthly Returns.

SEC. 504. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid the following taxes on the issuance of insurance policies:

When Effective.

(a) Life insurance: A tax equivalent to 8 cents on each $100 or fractional part thereof of the amount for which any life is insured under any policy of insurance, or other instrument, by whatever name the same is called: *Provided*, That on all policies for life insurance only by which a life is insured not in excess of $500, issued on the industrial or weekly-payment plan of insurance, the tax shall be forty per centum of the amount of the first weekly premium: *Provided further*, That policies of reinsurance shall be exempt from the tax imposed by this subdivision;

Life Insurance.

(b) Marine, inland, and fire insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy

of insurance or other instrument by whatever name the same is called whereby insurance is made or renewed upon property of any description (including rents or profits), whether against peril by sea or inland waters, or by fire or lightning, or other peril: *Provided*, That policies of reinsurance shall be exempt from the tax imposed by this subdivision;

Marine, Inland Fire Insurance.

(c) Casualty insurance: A tax equivalent to 1 cent on each dollar or fractional part thereof of the premium charged under each policy of insurance or obligation of the nature of indemnity for loss, damage, or liability (except bonds taxable under subdivision two of schedule A of Title VIII) issued or executed or renewed by any person, corporation, partnership, or association, transacting the business of employers' liability, workmen's compensation, accident, health, tornado, plate glass, steam boiler, elevator, burglary, automatic sprinkler, automobile, or other branch of insurance (except life insurance, and insurance described and taxed in the preceding subdivision): *Provided*, That policies of reinsurance shall be exempt from the tax imposed by this subdivision;

Casualty Insurance.

(d) Policies issued by any person, corporation, partnership, or association, whose income is exempt from taxation under Title I of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, shall be exempt from the taxes imposed by this section.

Exempt Organizations.

SEC. 505. That every person, corporation, partnership, or association, issuing policies of insurance upon the issuance of which a tax is imposed by section five hundred and four, shall, within the first fifteen days of each month, make a return under oath, in duplicate, and pay such tax to the collector of internal revenue of the district in which the principal office or place of business of such person, corporation, partnership, or association is located. Such returns shall contain such information and be made in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation prescribe.

Monthly Returns.

TITLE VI.—WAR EXCISE TAXES

SEC. 600. That there shall be levied, assessed, collected, and paid—

Automobiles, Auto Trucks, Motorcycles.

(a) Upon all automobiles, automobile trucks, automobile wagons, and motorcycles, sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold; and

(b) Upon all piano players, graphophones, phonographs, talking machines, and records used in connection with any musical instrument, piano player, graphophone, phonograph, or talking machine, sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold; and

Piano Players, Phonographs.

(c) Upon all moving-picture films (which have not been exposed) sold by the manufacturer or importer a tax equivalent to one-fourth of 1 cent per linear foot; and

Films.

(d) Upon all positive moving-picture films (containing a picture ready for projection) sold or leased by the manufacturer, producer, or importer, a tax equivalent to one-half of 1 cent per linear foot; and

(e) Upon any article commonly or commercially known as jewelry, whether real or imitation, sold by the manufacturer, producer, or importer thereof, a tax equivalent to three per centum of the price for which so sold; and **Jewelry.**

(f) Upon all tennis rackets, golf clubs, baseball bats, lacrosse sticks, balls of all kinds, including baseballs, foot balls, tennis, golf, lacrosse, billiard and pool balls, fishing rods and reels, billiard and pool tables, chess and checker boards and pieces, dice, games and parts of games, except playing cards and children's toys and games, sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold; and **Sporting Goods** **Toys.**

(g) Upon all perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair-dyes, tooth and mouth washes, dentifrices, tooth pastes, aromatic cachous, toilet soaps and powders, or any similar substance, article, or preparation by whatsoever name known or distinguished, upon all of the above which are used or applied or intended to be used or applied for toilet purposes, and which are sold by the manufacturer, importer, or producer, a tax equivalent to two per centum of the price for which so sold; and **Perfumes, Toilet Articles.**

(h) Upon all pills, tablets, powders, tinctures, troches or lozenges, sirups, medicinal cordials or bitters, anodynes, tonics, plasters, liniments, salves, ointments, pastes, drops, waters (except those taxed under section three hundred and thirteen of this Act), essences, spirits, oils, and all medicinal preparations, compounds, or compositions whatsoever, the manufacturer or producer of which claims to have any private formula, secret, or occult art for making or preparing the same, or has or claims to have any exclusive right or title to the making or preparing the same, or which are prepared, uttered, vended, or exposed for sale under any letters patent, or trade-mark, or which, if prepared by any formula, published or unpublished, are held out or recommended to the public by the makers, venders, or proprietors thereof as proprietary medicines or medicinal proprietary articles or preparations, or as remedies or specifics for any disease, diseases, or affection whatever affecting the human or animal body, and which are sold by the manufacturer, producer, or importer, a tax equivalent to two per centum of the price for which so sold; and **Proprietary Medicines.** **Rate of Tax.**

(i) Upon all chewing gum or substitute therefor sold by the manufacturer, producer, or importer, a tax equivalent to two per centum of the price for which so sold; and **Chewing Gum.**

(j) Upon all cameras sold by the manufacturer, producer, or importer, a tax equivalent to three per centum of the price for which so sold. **Cameras.**

SEC. 601. That each manufacturer, producer, or importer of any of the articles enumerated in section six hundred shall make monthly returns

under oath in duplicate and pay the taxes imposed on such articles by this title to the collector of internal revenue for the district in which is located the principal place of business. Such returns shall contain such information and be made at such times and in such manner as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulations prescribe.

Monthly Returns.

SEC. 602. That upon all articles enumerated in subdivisions (a), (b), (e), (f), (g), (h), (i), or (j) of section six hundred, which on the day this Act is passed are held and intended for sale by any person, corporation, partnership, or association, other than (1) a retailer who is not also a wholesaler, or (2) the manufacturer, producer, or importer thereof, there shall be levied, assessed, collected, and paid a tax equivalent to one-half the tax imposed by each such subdivision upon the sale of the articles therein enumerated. This tax shall be paid by the person, corporation, partnership, or association so holding such articles.

Floor Tax.

The taxes imposed by this section shall be assessed, collected, and paid in the same manner as provided in section ten hundred and two in the case of additional taxes upon articles upon which the tax imposed by existing law has been paid.

Nothing in this section shall be construed to impose a tax upon articles sold and delivered prior to May ninth, nineteen hundred and seventeen, where the title is reserved in the vendor as security for the payment of the purchase money.

Limitation.

SEC. 603. That on the day this Act takes effect, and thereafter on July first in each year, and also at the time of the original purchase of a new boat by a user, if on any other date than July first, there shall be levied, assessed, collected, and paid upon the use of yachts, pleasure boats, power boats, and sailing boats, of over five net tons, and motor boats with fixed engines, not used exclusively for trade or national defense, or not built according to plans and specifications approved by the Navy Department, an excise tax to be based on each yacht or boat, at rates as follows: Yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, of over five net tons, length not over fifty feet, 50 cents for each foot, length over fifty feet and not over one hundred feet, $1 for each foot, length over one hundred feet, $2 for each foot; motor boats of not over five net tons with fixed engines, $5.

Yachts.

Pleasure Boats.

Rate of Tax.

In determining the length of such yachts, pleasure boats, power boats, motor boats with fixed engines, and sailing boats, the measurement of over-all length shall govern.

Determining Length.

In the case of a tax imposed at the time of the original purchase of a new boat on any other date than July first, the amount to be paid shall be the same number of twelfths of the amount of the tax as the number of calendar months, including the month of sale, remaining prior to the following July first.

Apportionment of Tax.

TITLE VII.—WAR TAX ON ADMISSIONS AND DUES

SEC. 700. That from and after the first day of November, nineteen

hundred and seventeen, there shall be levied, assessed, collected, and paid (a) a tax of 1 cent for each 10 cents or fraction thereof of the amount paid for admission to any place, including admission by season ticket or subscription, to be paid by the person paying for such admission: *Provided*, That the tax on admission of children under twelve years of age where an admission charge for such children is made shall in every case be 1 cent; and (b) in the case of persons (except bona fide employees, municipal officers on official business, and children under twelve years of age) admitted free to any place at a time when and under circumstances under which an admission charge is made to other persons of the same class, a tax of 1 cent for each 10 cents or fraction thereof of the price so charged to such other persons for the same or similar accommodations, to be paid by the person so admitted; and (c) a tax of 1 cent for each 10 cents or fraction thereof paid for admission to any public performance for profit at any cabaret or other similar entertainment to which the charge for admission is wholly or in part included in the price paid for refreshment, service, or merchandise; the amount paid for such admission to be computed under rules prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, such tax to be paid by the person paying for such refreshment, service, or merchandise. In the case of persons having the permanent use of boxes or seats in an opera house or any place of amusement or a lease for the use of such box or seat in such opera house or place of amusement there shall be levied, assessed, collected, and paid a tax equivalent to ten per centum of the amount for which a similar box or seat is sold for performance or exhibition at which the box or seat is used or reserved by or for the lessee or holder. These taxes shall not be imposed in the case of a place the maximum charge for admission to which is 5 cents, or in the case of shows, rides, and other amusements, (the maximum charge for admission to which is 10 cents) within outdoor general amusement parks, or in the case of admissions to such parks.

Admissions Rate of Tax.

Cabaret.

Leased Boxes and Seats.

Tax not Imposed.

No tax shall be levied under this title in respect to any admissions all the proceeds of which inure exclusively to the benefit of religious, educational, or charitable institutions, societies, or organizations, or admissions to agricultural fairs none of the profits of which are distributed to stockholders or members of the association conducting the same.

Exemptions Religious, Educational, Charitable Functions.

The term "admission" as used in this title includes seats and tables, reserved or otherwise, and other similar accommodations, and the charges made therefor.

"Admission" Defined.

SEC. 701. That from and after the first day of November, nineteen hundred and seventeen, there shall be levied, assessed, collected, and paid, a tax equivalent to ten per centum of any amount paid as dues or membership fees (including initiation fees), to any social, athletic, or sporting club or organization, where such dues or fees are in excess of $12 per year; such taxes to be paid by the person

Club Dues, Membership Fees.

paying such dues or fees: *Provided*, That there shall be exempted from the provisions of this section all amounts paid as dues or fees to a fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

Exemption.

SEC. 702. That every person, corporation, partnership, or association (a) receiving any payments for such admission, dues, or fees, shall collect the amount of the tax imposed by section seven hundred or seven hundred and one from the person making such payments, or (b) admitting any person free to any place for admission to which a charge is made shall collect the amount of the tax imposed by section seven hundred and from the person so admitted, and (c) in either case shall make returns and payments of the amount so collected, at the same time and in the same manner as provided in section five hundred and three of this Act.

Returns Required.

TITLE VIII.—WAR STAMP TAXES

SEC. 800. That on and after the first day of December, nineteen hundred and seventeen, there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person, corporation, partnership, or association who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped, the several taxes specified in such schedule.

Stamp Taxes When Effective.

SEC. 801. That there shall not be taxed under this title any bond, note, or other instrument, issued by the United States, or by any foreign Government, or by any State, Territory or the District of Columbia, or local subdivision thereof, or municipal or other corporation exercising the taxing power, when issued in the exercise of a strictly governmental, taxing, or municipal function; or stocks and bonds issued by cooperative building and loan associations which are organized and operated exclusively for the benefit of their members and make loans only to their shareholders, or by mutual ditch or irrigating companies.

Exemptions.

SEC. 802. That whoever—

(a) Makes, signs, issues, or accepts, or causes to be made, signed, issued, or accepted, any instrument, document, or paper of any kind or description whatsoever without the full amount of tax thereon being duly paid;

Insufficient Amount of Stamps.

(b) Consigns or ships, or causes to be consigned or shipped, by parcel post any parcel, package, or article without the full amount of tax being duly paid;

(c) Manufactures or imports and sells, or offers for sale, or causes to be

manufactured or imported and sold, or offered for sale, any playing cards, package, or other article without the full amount of tax being duly paid;

(d) Makes use of any adhesive stamp to denote any tax imposed by this title without canceling or obliterating such stamp as prescribed in section eight hundred and four; **Failure to Cancel.**

Is guilty of a misdemeanor and upon conviction thereof shall pay a fine of not more than $100 for each offense. **Penalty.**

SEC. 803. That whoever—

(a) Fraudulently cuts, tears, or removes from any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, any adhesive stamp or the impression of any stamp, die, plate, or other article provided, made, or used in pursuance of this title; **Removing Stamps.**

(b) Fraudulently uses, joins, fixes, or places to, with, or upon any vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title, (1) any adhesive stamp, or the impression of any stamp, die, plate, or other article, which has been cut, torn, or removed from any other vellum, parchment, paper, instrument, writing, package, or article, upon which any tax is imposed by this title; or (2) any adhesive stamp or the impression of any stamp, die, plate, or other article of insufficient value; or (3) any forged or counterfeit stamp, or the impression of any forged or counterfeited stamp, die, plate, or other article; **Fraudulent Use of Stamps.**

(c) Willfully removes, or alters the cancellation, or defacing marks of, or otherwise prepares, any adhesive stamp, with intent to use, or cause the same to be used, after it has been already used, or knowingly or willfully buys, sells, offers for sale, or gives away, any such washed or restored stamp to any person for use, or knowingly uses the same; **Removes Stamps.**

(d) Knowingly and without lawful excuse (the burden of proof of such excuse being on the accused) has in possession any washed, restored, or altered stamp, which has been removed from any vellum, parchment, paper, instrument, writing, package, or article, is guilty of a misdemeanor, and upon conviction shall be punished by a fine of not more than $1,000, or by imprisonment for not more than five years, or both, in the discretion of the court, and any such reused, canceled, or counterfeit stamp and the vellum, parchment, document, paper, package, or article upon which it is placed or impressed shall be forfeited to the United States. **In Possession of Washed Stamps.** **Penalty.**

SEC. 804. That whenever an adhesive stamp is used for denoting any tax imposed by this title, except as hereinafter provided, the person, corporation, partnership, or association, using or affixing the same shall write or stamp or cause to be written or stamped thereupon the initials of his or its name and the date upon which the same is attached or used, so that the same may not again be used: *Provided*, That the Commissioner of Internal Revenue may prescribe such other method for the cancellation of such stamps as he may deem expedient. **Prescribed Method of Cancellation.**

SEC. 805. (a) That the Commissioner of Internal Revenue shall cause to be prepared and distributed for the payment of the taxes prescribed in this title suitable stamps denoting the tax on the document, articles, or thing to which the same may be affixed, and shall prescribe such method for the affixing of said stamps in substitution for or in addition to the method provided in this title, as he may deem expedient.

Preparation and Distribution of Stamps.

(b) The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is authorized to procure any of the stamps provided for in this title by contract whenever such stamps can not be speedily prepared by the Bureau of Engraving and Printing; but this authority shall expire on the first day of January, nineteen hundred and eighteen, except as to imprinted stamps furnished under contract, authorized by the Commissioner of Internal Revenue.

Procuring Stamps by Government.

(c) All internal-revenue laws relating to the assessment and collection of taxes are hereby extended to and made a part of this title, so far as applicable, for the purpose of collecting stamp taxes omitted through mistake or fraud from any instrument, document, paper, writing, parcel, package, or article named herein.

Assessment, Collection.

SEC. 806. That the Commissioner of Internal Revenue shall furnish to the Postmaster General without prepayment a suitable quantity of adhesive stamps to be distributed to and kept on sale by the various postmasters in the United States. The Postmaster General may require each such postmaster to give additional or increased bond as postmaster for the value of the stamps so furnished, and each such postmaster shall deposit the receipts from the sale of such stamps to the credit of and render accounts to the Postmaster General at such times and in such form as he may by regulations prescribe. The Postmaster General shall at least once monthly transfer all collections from this source to the Treasury as internal-revenue collections.

Stamps Advanced to Postmasters.

SEC. 807. That the collectors of the several districts shall furnish without prepayment to any assistant treasurer or designated depositary of the United States located in their respective collection districts a suitable quantity of adhesive stamps for sale. In such cases the collector may require a bond, with sufficient sureties, to an amount equal to the value of the adhesive stamps so furnished, conditioned for the faithful return, whenever so required, of all quantities or amounts undisposed of, and for the payment monthly of all quantities or amounts sold or not remaining on hand. The Secretary of the Treasury may from time to time made such regulations as he may find necessary to insure the safe-keeping or prevent the illegal use of all such adhesive stamps.

Sale of Stamps.

SCHEDULE A.—STAMP TAXES

1. Bonds of indebtedness: Bonds, debentures, or certificates of indebtedness issued on and after the first day of December, nineteen hundred and seventeen, by any person, corporation, partnership, or association, on each $100 of face value or fraction thereof, 5 cents:

Bonds, Debentures.

Provided, That every renewal of the foregoing shall be taxed as a new issue: *Provided further*, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured. **Rate of Tax.**

2. Bonds, indemnity and surety: Bonds for indemnifying any person, corporation, partnership, or corporation who shall have become bound or engaged as surety, and all bonds for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for money received by virtue thereof, and all other bonds of any description, except such as may be required in legal proceedings, not otherwise provided for in this schedule, 50 cents; *Provided*, That where a premium is charged for the execution of such bond the tax shall be paid at the rate of one per centum on each dollar or fractional part thereof of the premium charged: *Provided further*, That policies of reinsurance shall be exempt from the tax imposed by this subdivision. **Surety Bonds.** **Rate of Tax.**

3. Capital stock, issue: On each original issue, whether an organization or reorganization, of certificates of stock by any association, company, or corporation, on each $100 of face value or fraction thereof, 5 cents: *Provided*, That where capital stock is issued without face value, the tax shall be 5 cents per share, unless the actual value is in excess of $100 per share, in which case the tax shall be 5 cents on each $100 of actual value or fraction thereof. **Capital Stock.** **Original Issue.**

The stamps representing the tax imposed by this subdivision shall be attached to the stock books and not to the certificates issued.

4. Capital stock, sales or transfers: On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to shares or certificates of stock in any association, company, or corporation, whether made upon or shown by the books of the association, company, or corporation, or by any assignment in blank, or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale, whether entitling the holder in any manner to the benefit of such stock or not, on each $100 of face value or fraction thereof, 2 cents, and where such shares of stock are without par value, the tax shall be 2 cents on the transfer or sale or agreement to sell on each share, unless the actual value thereof is in excess of $100 per share, in which case the tax shall be 2 cents on each $100 of actual value or fraction thereof: *Provided*, That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of stock certificates as collateral security for money loaned thereon, which stock certificates are not actually sold, nor upon such stock certificates so deposited: *Provided further*, That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: *Provided further*, That in case of sale where the evidence of transfer is shown only by the books of the company the stamp shall be placed upon such books; and where the change of owner- **Capital Stock, Sales and Transfers.** **Rate of Tax.** **Exception.**

ship is by transfer of the certificate the stamp shall be placed upon the certificate; and in cases of an agreement to sell or where the transfer is by delivery of the certificate assigned in blank there shall be made and delivered by the seller to the buyer a bill or memorandum of such sale, to which the stamp shall be affixed; and every bill or memorandum of sale or agreement to sell before mentioned shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers. Any person or persons liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person or persons who shall make any such sale, or who shall in pursuance of any such sale deliver any stock or evidence of the sale of any stock or bill or memorandum thereof, as herein required, without having the proper stamps affixed thereto with intent to evade the foregoing provisions shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both, at the discretion of the court.

Affixing Stamps.

Agents, Brokers.

Penalty.

5. Produce, sales of, on exchange: Upon each sale, agreement of sale, or agreement to sell, including so-called transferred or scratch sales, any products or merchandise at any exchange, or board of trade, or other similar place, for future delivery, for each $100 in value of the merchandise covered by said sale or agreement of sale or agreement to sell, 2 cents, and for each additional $100 or fractional part thereof in excess of $100, 2 cents: *Provided*, That on every sale or agreement of sale or agreement to sell as aforesaid there shall be made and delivered by the seller to the buyer a bill, memorandum, agreement, or other evidence of such sale, agreement of sale, or agreement to sell, to which there shall be affixed a lawful stamp or stamps in value equal to the amount of the tax on such sale: *Provided further*, That sellers of commodities described herein, having paid the tax provided by this subdivision, may transfer such contracts to a clearing house corporation or association, and such transfer shall not be deemed to be a sale, or agreement of sale, or an agreement to sell within the provisions of this Act, provided that such transfer shall not vest any beneficial interest in such clearing house association but shall be made for the sole purpose of enabling such clearing house association to adjust and balance the accounts of the members of said clearing house association on their several contracts. And every such bill, memorandum, or other evidence of sale or agreement to sell shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers; and any person or persons liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person or persons, who shall make any such sale or agreement of sale, or agreement to sell, or who shall, in pursuance of any such sale, agreement of sale, or agreement to sell, deliver any such products or merchandise without a bill, memorandum, or other evidence thereof as herein required, or who shall deliver such bill, memorandum, or other evidence of sale, or agreement to sell, without having the proper stamps affixed

Sale of Produce on Exchange.

Rate of Tax.

Evidence of Sale.

Agreement of Sale.

thereto, with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both, at the discretion of the court. **Penalties.**

That no bill, memorandum, agreement, or other evidence of such sale, or agreement of sale, or agreement to sell, in case of cash sales of products or merchandise for immediate or prompt delivery which in good faith are actually intended to be delivered shall be subject to this tax. **Sales Exempt.**

6. Drafts or checks payable otherwise than at sight or on demand, promissory notes, except bank notes issued for circulation, and for each renewal of the same, for a sum not exceeding $100, 2 cents; and for each additional $100 or fractional part thereof, 2 cents. **Time Drafts and Notes.**

7. Conveyance: Deed, instrument, or writing, whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers, or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100 and does not exceed $500, 50 cents; and for each additional $500 or fractional part thereof 50 cents: *Provided*, That nothing contained in this paragraph shall be so construed as to impose a tax upon any instrument or writing given to secure a debt. **Conveyances.** **Rate of Tax.**

8. Entry of any goods, wares, or merchandise at any custom-house, either for consumption or warehousing, not exceeding $100 in value, 25 cents; exceeding $100 and not exceeding $500 in value, 50 cents; exceeding $500 in value, $1. **Custom House Entries.**

9. Entry for the withdrawal of any goods or merchandise from customs bonded warehouse, 50 cents.

10. Passage ticket, one way or round trip, for each passenger, sold or issued in the United States for passage by any vessel to a port or place not in the United States, Canada, or Mexico, if costing not exceeding $30, $1; costing more than $30 and not exceeding $60, $3; costing more than $60, $5: *Provided*, That such passage tickets, costing $10 or less, shall be exempt from taxation. **Passage Tickets.**

11. Proxy for voting at any election for officers, or meeting for the transaction of business, of any incorporated company or association, except religious, educational, charitable, fraternal, or literary societies, or public cemeteries, 10 cents. **Proxies.**

12. Power of attorney granting authority to do or perform some act for or in behalf of the grantor, which authority is not otherwise vested in the grantee, 25 cents: *Provided*, That no stamps shall be required upon any papers necessary to be used for the collection of claims from the United States or from any State for pensions, back pay, bounty, or for property lost in the military or naval service or upon powers of attorney required in bankruptcy cases. **Powers of Attorney.**

13. Playing cards: Upon every pack of playing cards, containing not more than fifty-four cards, manufactured or imported, and sold, or removed for consumption or sale, after the passage of this Act, a tax of 5 cents per pack in addition to the tax imposed under existing law.

Playing Cards.

14. Parcel-post packages: Upon every parcel or package transported from one point in the United States to another by parcel post on which the postage amounts to 25 cents or more, a tax of 1 cent for each 25 cents or fractional part thereof charged for such transportation, to be paid by the consignor.

Parcel Post Packages.

No such parcel or package shall be transported until a stamp or stamps representing the tax due shall have been affixed thereto.

TITLE IX.—WAR ESTATE TAX

SEC. 900. That in addition to the tax imposed by section two hundred and one of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended—

When Effective.

(a) A tax equal to the following percentages of its value is hereby imposed upon the transfer of each net estate of every decedent dying after the passage of this Act, the transfer of which is taxable under such section (the value of such net estate to be determined as provided in Title II of such Act of September eighth, nineteen hundred and sixteen):

Rates of Tax.

One-half of one per centum of the amount of such net estate not in excess of $50,000;

One per centum of the amount by which such net estate exceeds $50,000 and does not exceed $150,000;

One and one-half per centum of the amount by which such net estate exceeds $150,000 and does not exceed $250,000;

Two per centum of the amount by which such net estate exceeds $250,000 and does not exceed $450,000;

Two and one-half per centum of the amount by which such net estate exceeds $450,000 and does not exceed $1,000,000;

Three per centum of the amount by which such net estate exceeds $1,000,000 and does not exceed $2,000,000;

Three and one-half per centum of the amount by which such net estate exceeds $2,000,000 and does not exceed $3,000,000;

Four per centum of the amount by which such net estate exceeds $3,000,000 and does not exceed $4,000,000;

Four and one-half per centum of the amount by which such net estate exceeds $4,000,000 and does not exceed $5,000,000;

Five per centum of the amount by which such net estate exceeds $5,000,000 and does not exceed $8,000,000;

Seven per centum of the amount by which such net estate exceeds $8,000,000 and does not exceed $10,000,000; and

Ten per centum of the amount by which such net estate exceeds $10,000,000.

SEC. 901. That the tax imposed by this title shall not apply to the transfer of the net estate of any decedent dying while serving in the military or naval forces of the United States, during the continuance of the war in which the United States is now engaged, or if death results from injuries received or disease contracted in such service, within one year after the termination of such war. For the purposes of this section the termination of the war shall be evidenced by the proclamation of the President. **In Military Service Exempt.**

TITLE X.—ADMINISTRATIVE PROVISIONS

SEC. 1000. That there shall be levied, collected, and paid in the United States, upon articles coming into the United States from the West Indian Islands acquired from Denmark, a tax equal to the internal-revenue tax imposed in the United States upon like articles of domestic manufacture; such articles shipped from said islands to the United States shall be exempt from the payment of any tax imposed by the internal-revenue laws of said islands: *Provided*, That there shall be levied, collected, and paid in said islands, upon articles imported from the United States, a tax equal to the internal-revenue tax imposed in said islands upon like articles there manufactured; and such articles going into said islands from the United States shall be exempt from payment of any tax imposed by the internal-revenue laws of the United States. **Imports from West Indian Islands.**

SEC. 1001. That all administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person, corporation, partnership, or association liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe. **Administration Assessment.**

SEC. 1002. That where additional taxes are imposed by this Act upon articles or commodities, upon which the tax imposed by existing law has been paid, the person, corporation, partnership, or association required by this Act to pay the tax shall, within thirty days after its passage, make return under oath in such form and under such regulations as the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury shall prescribe. Payment of the tax shown to be due may be extended to a date not exceeding seven months from the passage of this Act, upon the filing of a bond for payment in such form and amount and with such sureties as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe. **Additional Taxes.**

SEC. 1003. That in all cases where the method of collecting the tax imposed by this Act is not specifically provided, the tax shall be collected in

such manner as the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury may prescribe. All administrative and penalty provisions of Title VIII of this Act, in so far as applicable, shall apply to the collection of any tax which the Commissioner of Internal Revenue determines or prescribes shall be paid by stamp.

Method of Collection.

SEC. 1004. That whoever fails to make any return required by this Act, or the regulations made under authority thereof within the time prescribed or who makes any false or fraudulent return, and whoever evades or attempts to evade any tax imposed by this Act or fails to collect or truly to account for and pay over any such tax, shall be subject to a penalty of not more than $1,000, or to imprisonment for not more than one year, or both, at the discretion of the court, and in addition thereto a penalty of double the tax evaded, or not collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected, in any case in which the punishment is not otherwise specifically provided.

Penalties.

SEC. 1005. That the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

Rules and Regulations.

SEC. 1006. That where the rate of tax imposed by this Act, payable by stamps, is an increase over previously existing rates, stamps on hand in the collectors' offices and in the Bureau of Internal Revenue may continue to be used until the supply on hand is exhausted, but shall be sold and accounted for at the rates provided by this Act, and assessment shall be made against manufacturers and other taxpayers having such stamps on hand on the day this Act takes effect for the difference between the amount paid for such stamps and the tax due at the rates provided by this Act.

Stamps on Hand.

SEC. 1007. That (a) if any person, corporation, partnership, or association has prior to May ninth, nineteen hundred and seventeen, made a bona fide contract with a dealer for the sale, after the tax takes effect, of any article, (or in the case of moving picture films, such a contract with a dealer, exchange, or exhibitor, for the sale or lease thereof) upon which a tax is imposed under Title III, IV, or VI, or under subdivision thirteen of Schedule A of Title VIII, or under this section, and (b) if such contract does not permit the adding of the whole of such tax to the amount to be paid under such contract, then the vendee or lessee shall, in lieu of the vendor or lessor, pay so much of such tax as is not so permitted to be added to the contract price.

Prior Contracts.

The taxes payable by the vendee or lessee under this section shall be paid to the vendor or lessor at the time the sale or lease is consummated, and collected, returned, and paid to the United States by such vendor or lessor in the same manner as provided in section five hundred and three.

Vendor, Lessor.

The term "dealer" as used in this section includes a vendee who purchases any article with intent to use it in the manufacture or production of another article intended for sale.

"Dealer" Defined.

SEC. 1008. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to one cent. **Fraction of Cent.**

SEC. 1009. That the Secretary of the Treasury, under rules and regulations prescribed by him, shall permit taxpayers liable to income and excess profits taxes to make payments in advance in installments or in whole of an amount not in excess of the estimated taxes which will be due from them, and upon determination of the taxes actually due any amount paid in excess shall be refunded as taxes erroneously collected: *Provided*, That when payment is made in installments at least one-fourth of such estimated tax shall be paid before the expiration of thirty days after the close of the taxable year, at least an additional one-fourth within two months after the close of the taxable year, at least an additional one-fourth within four months after the close of the taxable year, and the remainder of the tax due on or before the time now fixed by law for such payment: *Provided further*, That the Secretary of the Treasury, under rules and regulations prescribed by him, may allow credit against such taxes so paid in advance of an amount not exceeding three per centum per annum calculated upon the amount so paid from the date of such payment to the date now fixed by law for such payment; but no such credit shall be allowed on payments in excess of taxes determined to be due, nor on payments made after the expiration of four and one-half months after the close of the taxable year. All penalties provided by existing law for failure to pay tax when due are hereby made applicable to any failure to pay the tax at the time or times required in this section. **Advance Installment, Payments of Income and Excess Profits Taxes.**

SEC. 1010. That under rules and regulations prescribed by the Secretary of the Treasury, collectors of internal revenue may receive, at par and accrued interest, certificates of indebtedness issued under section six of the Act entitled "An Act to authorize an issue of bonds to meet expenditures for the national security and defense, and, for the purpose of assisting in the prosecution of the war, to extend credit to foreign governments, and for other purposes," approved April twenty-fourth, nineteen hundred and seventeen, and any subsequent Act or Acts, and uncertified checks in payment of income and excess-profits taxes, during such time and under such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered. **Payment by Certificates of Indebtedness. Uncertified Checks.**

TITLE XI.—POSTAL RATES

SEC. 1100. That the rate of postage on all mail matter of the first class, except postal cards, shall thirty days after the passage of this Act be, in addition to the existing rate, 1 cent for each ounce or fraction thereof:

Provided, That the rate of postage on drop letters of the first class shall be 2 cents an ounce or fraction thereof. Postal cards, and private mailing or post cards when complying with the requirements of existing law, shall be transmitted through the mails at 1 cent each in addition to the existing rate.

Mail Matter First Class.

That letters written and mailed by soldiers, sailors, and marines assigned to duty in a foreign country engaged in the present war may be mailed free of postage, subject to such rules and regulations as may be prescribed by the Postmaster General.

Free of Postage.

SEC. 1101. That on and after July first, nineteen hundred and eighteen, the rates of postage on publications entered as second-class matter (including sample copies to the extent of ten per centum of the weight of copies mailed to subscribers during the calendar year) when sent by the publisher thereof from the post office of publication or other post office, or when sent by a news agent to actual subscribers thereto, or to other news agents for the purpose of sale:

Second Class Mail.

(a) In the case of the portion of such publication devoted to matter other than advertisements, shall be as follows: (1) On and after July first, nineteen hundred and eighteen, and until July first, nineteen hundred and nineteen, 1¼ cents per pound or fraction thereof; (2) on and after July first, nineteen hundred and nineteen, 1½ cents per pound or fraction thereof.

Rates of Tax.

(b) In the case of the portion of such publication devoted to advertisements the rates per pound or fraction thereof for delivery within the several zones applicable to fourth-class matter shall be as follows (but where the space devoted to advertisements does not exceed five per centum of the total space, the rate of postage shall be the same as if the whole of such publication was devoted to matter other than advertisements): (1) On and after July first, nineteen hundred and eighteen, and until July first, nineteen hundred and nineteen, for the first and second zones, 1¼ cents; for the third zone, 1½ cents; for the fourth zone, 2 cents; for the fifth zone, 2¼ cents; for the sixth zone, 2½ cents; for the seventh zone, 3 cents; for the eighth zone, 3¼ cents; (2) on and after July first, nineteen hundred and nineteen, and until July first, nineteen hundred and twenty, for the first and second zones, 1½ cents; for the third zone, 2 cents; for the fourth zone, 3 cents; for the fifth zone 3½ cents; for the sixth zone, 4 cents; for the seventh zone, 5 cents; for the eighth zone, 5½ cents; (3) on and after July first, nineteen hundred and twenty, and until July first, nineteen hundred and twenty-one, for the first and second zones, 1¾ cents; for the third zone, 2½ cents; for the fourth zone, 4 cents; for the fifth zone, 4¾ cents; for the sixth zone, 5½ cents; for the seventh zone, 7 cents; for the eighth zone, 7¾ cents; (4) on and after July first, nineteen hundred and twenty-one, for the first and second zones, 2 cents; for the third zone, 3 cents; for the fourth zone, 5 cents; for the fifth zone, 6 cents; for the sixth zone, 7 cents; for the seventh zone, 9 cents; for the eighth zone, 10 cents;

Portion Devoted to Advertisements.

Rates July 1, 1918,

July 1, 1919,

July 1, 1920.

July 1, 1921.

(c) With the first mailing of each issue of each such publication, the publisher shall file with the postmaster a copy of such issue, together with a statement containing such information as the Postmaster General may prescribe for determining the postage chargeable thereon. **File Copy.**

SEC. 1102. That the rate of postage on daily newspapers, when the same are deposited in a letter-carrier office for delivery by its carriers, shall be the same as now provided by law; and nothing in this title shall affect existing law as to free circulation and existing rates on second-class mail matter within the county of publication: *Provided*, That the Postmaster General may hereafter require publishers to separate or make up to zones in such a manner as he may direct all mail matter of the second class when offered for mailing. **Daily Newspapers.**

SEC. 1103. That in the case of newspapers and periodicals entitled to be entered as second-class matter and maintained by and in the interest of religious, educational, scientific, philanthropic, agricultural labor, or fraternal organizations or associations, not organized for profit and none of the net income of which inures to the benefit of any private stockholder or individual, the second-class postage rates shall be, irrespective of the zone in which delivered (except when the same are deposited in a letter carrier office for delivery by its carriers, in which case the rates shall be the same as now provided by law), 1⅛ cents a pound or fraction thereof on and after July first, nineteen hundred and eighteen, and until July first, nineteen hundred and nineteen, and on and after July first, nineteen hundred and nineteen, 1¼ cents a pound or fraction thereof. The publishers of such newspapers or periodicals before being entitled to the foregoing rates shall furnish to the Postmaster General, at such times and under such conditions as he may prescribe, satisfactory evidence that none of the net income of such organization inures to the benefit of any private stockholder or individual. **Religious, Educational, etc., Publications. Rates.**

SEC. 1104. That where the total weight of any one edition or issue of any publication mailed to any one zone does not exceed one pound, the rate of postage shall be 1 cent. **Weight.**

SEC. 1105. The zone rates provided by this title shall relate to the entire bulk mailed to any one zone and not to individually addressed packages. **Zone Rates.**

SEC. 1106. That where a newspaper or periodical is mailed by other than the publisher or his agent or a news agent or dealer, the rate shall be the same as now provided by law.

SEC. 1107. That the Postmaster General, on or before the tenth day of each month, shall pay into the general fund of the Treasury an amount equal to the difference between the estimated amount received during the preceding month for the transportation of first class matter through the mails and the estimated amount which would have been received under the provisions of the law in force at the time of the passage of this Act. **Payment to General Fund.**

Salaries Postmasters.

SEC. 1108. That the salaries of postmasters at offices of the first, second, and third classes shall not be increased after July first, nineteen hundred and seventeen, during the existence of the present war. The compensation of postmasters at offices of the fourth class shall continue to be computed on the basis of the present rates of postage.

Leave for Military Service.

SEC. 1109. That where postmasters at offices of the third class have been since May first, nineteen hundred and seventeen, or hereafter are granted leave without pay for military purposes, the Postmaster General may allow, in addition to the maximum amounts which may now be allowed such offices for clerk hire, in accordance with law, an amount not to exceed fifty per centum of the salary of the postmaster.

Construction.

SEC. 1110. That section five of the Act approved March third, nineteen hundred and seventeen, entitled "An Act making appropriations for the Post Office Department for the year ending June thirtieth, nineteen hundred and eighteen," shall not be construed to apply to ethyl alcohol for governmental, scientific, medicinal, mechanical, manufacturing, and industrial purposes, and the Postmaster General shall prescribe suitable rules and regulations to carry into effect this section in connection with the Act of which it is amendatory, nor shall said section be held to prohibit the use of the mails by regularly ordained ministers of religion, or by officers of regularly established churches, for ordering wines for sacramental uses, or by manufacturers and dealers for quoting and billing such wines for such purposes only.

TITLE XII.—INCOME TAX AMENDMENTS

Inserted in Federal Income Tax Law (Appendix A, page 219.)

TITLE XIII.—GENERAL PROVISIONS

Saving Clause.

SEC. 1300. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment shall have been rendered.

Title Repealed.

SEC. 1301. That Title I of the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extension of fortifications, and for other purposes," approved March third, nineteen hundred and seventeen, be, and the same is hereby, repealed.

Effective.

SEC. 1302. That unless otherwise herein specially provided, this Act shall take effect on the day following its passage.

Approved, October 3, 1917.

APPENDIX C

FEDERAL CORPORATION CAPITAL STOCK TAX LAW

ENACTED SEPTEMBER 8, 1916

SEC. 407. That on and after January first, nineteen hundred and seventeen, special taxes shall be, and hereby are, imposed annually, as follows, that is to say: **When Effective.**

Every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States, or any State or Territory of the United States, shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to 50 cents for each $1,000 of the fair value of its capital stock and in estimating the value of capital stock, the surplus and undivided profits shall be included: *Provided*, That in the case of insurance companies such deposits and reserve funds as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders shall not be included. The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year: *Provided*, That for the purpose of this tax an exemption of $99,000 shall be allowed from the capital stock as defined in this paragraph of each corporation, joint-stock company or association, or insurance company: *Provided further*, That a corporation, joint-stock company or association, or insurance company, actually paying the tax imposed by section three hundred and one of Title III of this act shall be entitled to a credit as against the tax imposed by this paragraph equal to the amount of the tax so actually paid: *And provided further*, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or which is exempt under the provisions of section eleven, Title I, of this act.

All Corporations Organized for Profit.

Rate.

Exemption.

Munitions Tax Creditable.

Preceding Taxable Year.

Every corporation, joint-stock company or association, or insurance company, now or hereafter organized for profit under the laws of any foreign country and engaged in business in the United States shall pay annually a special excise tax with respect to the carrying on or doing business in the United States by such corporation joint-stock company or association, or insurance company, equivalent to 50 cents for each $1,000 of the capital actually invested in the transaction of its business in the United States: *Provided*, That

Foreign Corporations.

Rate.

in the case of insurance companies such deposits or reserve funds as they are required by law or contract to maintain or hold in the United States for the protection of or payment to or apportionment among policyholders, shall not be included. The amount of such annual tax shall in all cases be computed on the basis of the average amount of capital so invested during the preceding year: *Provided*, That for the purpose of this tax an exemption from the amount of capital so invested shall be allowed equal to such proportion of $99,000 as the amount so invested bears to the total amount invested in the transaction of business in the United States or elsewhere: *Provided, further*, That this exemption shall be allowed only if such corporation, joint-stock company or association, or insurance company makes return to the Commissioner of Internal Revenue, under regulations prescribed by him, with the approval of the Secretary of the Treasury, of the amount of capital invested in the transaction of business outside the United States: *And provided further*, That a corporation, joint-stock company or association, or insurance company actually paying the tax imposed by section three hundred and one of Title III of this act, shall be entitled to a credit as against the tax imposed by this paragraph equal to the amount of the tax so actually paid: *And provided further*, That this tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or which is exempt under the provisions of section eleven, Title I, of this act.

Reserve Funds of Insurance Companies. **Average Capital.** **Exemption.** **Munitions Tax.** **Preceding Year.**

SEC. 408. (Last paragraph.) Every preson who carries on any business or occupation for which special taxes are imposed by this title, without having paid the special tax therein provided, shall, besides being liable to the payment of such special tax, be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not more than $500, or be imprisoned not more than six months, or both, in the discretion of the court.

Penalty.

SEC. 409. That all administrative or special provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this title, and every person, firm, company, corporation, or association liable to any tax imposed by this title, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe.

Administration. **Records.**

REGULATIONS

Concerning the special excise tax imposed by section 407, Title IV, act of September 8, 1916, on corporations, joint-stock companies or associations, and insurance companies, organized for profit in the United States, and on the capital invested in the United States of foreign companies and associations transacting business in the United States.

RETURNS COMPUTATION OF TAX, COLLECTIONS, AND PENALTIES

Tax imposed

Article 1. Section 407 imposes a special excise tax with respect to the carrying on or doing business by corporations, joint-stock companies or associations, or insurance companies, as follows:

Corporations in the United States

(*a*) Every corporation, joint-stock company or association, or insurance company, now or hereafter organized in the United States for profit and having a capital stock represented by shares, 50 cents for each $1,000 of the fair value of the capital stock in excess of $99,000, except as hereinafter indicated; and

Foreign Corporations

(*b*) Every corporation, joint-stock company or association, or insurance company, now or hereafter organized for profit under the laws of any foreign country and engaged in business in the United States, 50 cents for each $1,000 of the capital actually invested in the transaction of its business in the United States. It is provided in cases in which the foreign corporation makes a return of the total amount of capital invested in the transaction of business, both abroad and in this country, that such proportion of $99,000 as the amount invested in the United States bears to the total amount invested in the United States and elsewhere may be remitted in computing the tax upon the capital invested in the United States.

Corporations Exempt

Corporations and associations exempt

Art. 2. (*a*) The following corporations, joint-stock companies or associations, or insurance companies, which are exempt from income tax under the provisions of section 11, Title I, are also specifically exempt from the capital-stock tax under section 407, Title IV, of this act:

First. Labor, agricultural, or horticultural organization;

Second. Mutual savings bank not having a capital stock represented by shares;

Third. Fraternal beneficiary society, order, or association, operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association, or their dependents;

Fouth. Domestic building and loan association and coöperative banks without capital stock organized and operated for mutual purposes and without profit;

Fifth. Cemetery company owned and operated exclusively for the benefit of its members;

Sixth. Corporation or association organized and operated exclusively for

religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual;

Seventh. Business league, chamber of commerce, or board of trade, not organized for profit and no part of the net income of which inures to the benefit of any private stockholder or individual;

Eighth. Civic league or organization not organized for profit but operated exclusively for the promotion of social welfare;

Ninth. Club organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net income of which inures to the benefit of any private stockholder or member;

Tenth. Farmers' or other mutual hail, cyclone, or fire insurance company, mutual ditch or irrigation company, mutual or coöperative telephone company, or like organization of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting its expenses;

Eleventh. Farmers,' fruit growers,' or like association, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

Twelfth. Corporation or association organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title; or

Thirteenth. Federal land banks and national farm-loan associations as provided in section twenty-six of the act approved July seventeenth, nineteen hundred and sixteen, entitled "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes."

Mutual companies exempt

(*b*) Inasmuch as the basis of tax is the fair value of the stock of a corporation, mutual insurance companies and other associations not having capital stock represented by shares will also be exempt from tax, in the absence of a basis for the computation of the tax.

Returns

Tax due in January and July, 1917, and annually in July thereafter

Art. 3. (*a*) Section 3237, Revised Statutes, as amended by section 53 of the act of October 1, 1890 (26 Stats., 567), provides "that all special taxes shall become due on the 1st day of July, 1891, and on the 1st day of July in each year thereafter, or on commencing any trade or business on which such tax is imposed. In the former case the tax shall be reckoned for one year, and in the latter case it shall be reckoned proportionately from the 1st day of the month in which the liability to a special tax com-

menced to the 1st day of July following." The capital-stock tax, therefore, which becomes effective January 1, 1917, will be payable in January, 1917, on returns to be made during that month for the six months ending June 30, 1917. In July, 1917, and annually in July thereafter, returns must again be made and the tax paid for the ensuing fiscal year.

Returns required of every United States corporation having capital stock outstanding of $75,000 or over

(*b*) Every corporation, joint-stock company or association, or insurance company, organized in the United States for profit and having a capital stock issued and outstanding, represented by shares of the market value of $75,000 or over, and not exempt as indicated in article 2, shall make a return on Form 707 irrespective of the par value of its capital stock, unless such corporation, joint-stock company or association, or insurance company was not engaged in business during the preceding taxable year, which for the return due January 1, 1917, shall be the fiscal year July 1, 1915, to June 30, 1916.

Return required of every foreign corporation

(*c*) Every corporation, joint-stock company or association, or insurance company, organized for profit under the laws of any foreign country and engaged in business in the United States, shall make return on Form 708 irrespective of the amount of capital employed either at home or in this country in the transaction of its business.

Form of return for United States corporations

Substance of return required from United States Corporations

Art. 4. The return required by article 3 of corporations, joint-stock companies or associations, or insurance companies, organized in the United States, shall be made on Form 707, to be supplied by this department, and shall set forth the following particulars:

(1) Total number of shares of stock now outstanding.
(2) Par value of shares.
(3) Par value of total capital stock outstanding.
(4) Amount of surplus.
(5) Amount of undivided profits.
(6) *Case I.*—Average market value per share during preceding fiscal year, if stock is listed on an exchange.

Case II.—If stock is not listed on an exchange, average market value per share computed from sales made during preceding fiscal year.

Case III.—If stock is not listed on any exchange and no sales have been made during preceding fiscal year, or if sales have been made and the price is unknown, the fair average value of the stock may be estimated from the following data set forth on the return: Amount of surplus, amount of undivided profits, nature of business, estimated earning capacity, average

dividends per share paid during preceding five years, average profits per share earned during preceding five years.

(7) Total number of shares of stock outstanding on last day of fiscal year.

(8) Fair value of total capital stock for preceding fiscal year.

(9) Deduction allowed by law of $99,000.

(10) Amount of fair value of stock over $99,000 upon which tax should be computed.

(11) Tax at rate of 50 cents per year for each full $1,000.

(12) Amount of munitions tax, if any, paid under Title III of this act since making the last previous return.

(13) Amount of tax due.

Form of return for foreign corporations

Substance of return required of foreign corporations

Art. 5. The return required by article 3 of foreign corporations, joint-stock companies or associations, or insurance companies, having capital invested in the transaction of its business in the United States, shall be made on Form 708, to be supplied by this department, and shall set forth the following particulars:

(1) Amount of capital invested in the United States.

(2) Amount of capital invested in foreign countries.

(3) Total amount of capital invested in the corporation, both in the United States and elsewhere.

(4) Percentage of capital invested in the United States.

(5) Percentage of $99,000 allowed to be deducted under the law.

(6) Amount of capital upon which tax should be computed.

(7) Tax at the rate of 50 cents per year for each full $1,000.

(8) Amount of munitions tax, if any, paid under Title III of this act since making the last previous return.

(9) Amount of tax due.

Computation of Tax

United States corporations

Art. 6. *Sec. 1. Companies or associations organized in the United States for profit.*—The tax on companies or associations having a capital stock represented by shares is imposed on the fair average value for the preceding year and not the face or par value of the capital stock. The fair value of the capital stock shall be ascertained as follows:

Stock listed on exchange

(*a*) *Case I.*—If the stock is listed on any exchange its fair value will be determined by adding the quoted highest bid price for the stock on the last business day of each month during the preceding fiscal year (or if no bid price was quoted on the last day then the latest day in the month on which

a bid was quoted), and dividing by 12, the result being the average bid price per share for that year.

Stock not listed, but of which sales have been made

(*b*) *Case II.*—If the stock is not listed on any exchange, but sales thereof have been actually made, and the price paid for the stock is known to the officer making the return, or can be discovered by him, the average price at which sales were made during the preceding fiscal year shall be the determining factor in ascertaining the fair value per share.

(In the foregoing two cases the actual fair value of the stock is ascertainable from the facts without the necessity of making an estimate.)

Cases in which fair average value of stock shall be estimated

(*c*) *Case III.*—If Case I and Case II can not be applied, viz., the stock is not listed on any exchange, and no actual sales have been made during the preceding fiscal year, or if the price at which sales have been made is not known to the officer making the return the fair average value of the capital stock shall be estimated, and the surplus and undivided profits for the preceding fiscal year will be taken into consideration as required by the statute, as well as the nature of the business, its earning capacity and average dividends paid, or profits earned during the preceding five years.

Fair value of total capital stock outstanding

(*d*) The fair value per share ascertained or estimated as above multiplied by the number of shares outstanding will give the fair value of the stock for taxation purposes.

Deduction of $99,000

(*e*) From this total will be deducted the sum of $99,000, the exemption allowed by law, and the tax will be laid upon the balance at the rate of 50 cents for each full $1,000 of the remainder.

Tax due January, 1917

(*f*) Upon the returns to be made during January, 1917, for the six months ending June 30, 1917, the tax due will be 25 cents per $1,000 of such remainder.

Deduction of munitions tax

(*g*) From the tax due as so determined will be deducted the amount of munitions tax, if any, actually paid since making the last previous return. As the special excise tax on capital stock is due in January, 1917, and the munitions tax will not be determined and assessed until March or April, no deductions for munitions tax will be allowed on the January, 1917, return. Deductions, however, will be allowed on the July, 1917, return for munitions taxes actually paid prior to that date.

SEC. 2. *Corporations, joint-stock companies or associations, or insurance companies, organized for profit under the laws of any foreign country and engaged in business in the United States.*

Foreign corporations

(*a*) The tax imposed on such companies or associations shall be computed upon the actual capital invested in the transaction of its business in the United States. The basis of taxation is the *average* amount of capital so invested during the preceding fiscal year. .

Deduction of proportion of $99,000 only allowed if corporation makes return of total capital invested

(*b*) The exemption from the amount of capital invested in the United States equal to the proportion of $99,000 as the amount so invested bears to the total amount invested in the transaction of business in the United States or elsewhere shall only be allowed a company or association which makes return to the Commissioner of Internal Revenue, under these regulations, of the amount of capital invested in the transaction of business outside of the United States. Thus a foreign company or association investing part of its capital in the transaction of business in the United States shall be liable for tax in the amount of 50 cents for each $1,000 of the actual capital invested in the United States, without deduction of the said proportion of $99,000, unless it discloses in its return the amount of capital invested in the transaction of business outside of the United States.

Corporations not in business during preceding taxable year

SEC. 3. *Corporations not engaged in business during preceding taxable year.*— This tax shall not be imposed upon any corporation, joint-stock company or association, or insurance company not engaged in business during the preceding taxable year, or in the case of the taxable period ending June 30, 1917, not so engaged during the year July 1, 1915, to June 30, 1916. The tax shall be computed upon each full value of $1,000 and not on any fractional part thereof.

Collection of tax

Special list, Form 23c

Art. 7. On account of the impracticability of issuing stamps in the various amounts, this tax will be collected by assessment on a special list for the months of January and July, 1917, and annually thereafter in July. Any delinquent returns made in February or other months, or any assessments for delinquency in taxes, may be listed on the regular list Form 23, and collected in the usual way.

Returns retained by collector

(*a*) Returns listed on special lists will be retained in the office of the collector as the special list will be prepared so as to give the essential data shown by the return.

Returns forwarded to commissioner

(*b*) Returns listed on regular lists will be forwarded to this office with the list for audit.

Penalty of 5 per cent.

(*c*) Upon failure to pay the tax assessed within 10 days, after notice and demand, a penalty of 5 per cent. of the tax unpaid and interest at the rate of 1 per cent. per month until paid shall be added to the amount of such tax.

Penalties

Administrative and assessment laws applicable to this law.

Art. 8. (*a*) Under section 409 it is provided that "all administrative or special provisions of law, including the law relating to the assessment of taxes so far as applicable, are hereby extended to and made a part of Title IV, and every person, firm, company, corporation, or association liable to any tax imposed by this title shall keep such records and render under oath such statements and returns as shall comply with such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may from time to time prescribe."

Penalties for failure to make return

(*b*) Any company or association, therefore, subject to special tax under section 407 of this act, which fails to make returns during the months of January, 1917, and July, 1917, and annually in July thereafter, will be liable to the penalties imposed by section 3176, Revised Statutes, as amended by section 16, act of September 8, 1916, which reads as follows:

Collector may make the return

If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law, or makes, wilfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. Any return or list so made and subscribed by a collector or deputy collector shall be prima facie good and sufficient for all legal purposes.

Extension of 30 days

If the failure to file a return or list is due to sickness or absence the collector may allow such further time, not exceeding thirty days, for making and filing the return or list as he deems proper.

Fifty per cent. penalty

The Commissioner of Internal Revenue shall assess all taxes, other than stamp taxes, as to which returns or lists are so made by a collector or deputy

collector. In case of any failure to make and file a return or list within the time prescribed by law or by the collector, the Commissioner of Internal Revenue shall add to the tax fifty per centum of its amount except that, when a return is voluntarily and without notice from the collector filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner of Internal Revenue shall add to the tax one hundred per centum of its amount.

The amount so added to any tax shall be collected at the same time and in the same manner and as part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax.

(*c*) In addition to the penalties imposed by section 3176, Revised Statutes, section 408 provides as follows:

Specific penalty

Every person who carries on any business or occupation for which special taxes are imposed by this title, without having paid the special tax therein provided, shall, besides being liable to the payment of such special tax, be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not more than $500, or be imprisoned not more than six months, or both, in the discretion of the court.

W. H. OSBORN,
Commissioner of Internal Revenue.

Approved:
WM. P. MALBURN,
Acting Secretary of the Treasury.

(T. D. 2418)

CITATIONS FROM DECISIONS OF THE SUPREME COURT REGARDING "DOING BUSINESS" UNDER CAPITAL-STOCK TAX, ACT OF SEPTEMBER 8, 1916

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., December 15, 1916.[1]

TO COLLECTORS OF INTERNAL REVENUE:

The following decisions made in cases arising under the corporation-tax Act of August 5, 1909, will be followed where they are final or have been acquiesced in by the department in similar questions arising under the special excise tax imposed by section 407, Title IV, act of September 8, 1916:

I. When is a corporation "engaged in business," "doing business," or "transacting business"? [¶ 3096].

II. "Massachusetts trusts" are exempt from the special excise tax [¶ 3097].

[1] Released for publication December 21, 1916.

III. Filing of returns [¶ 3098].

IV. Foreign corporations transacting business in the United States [¶ 3099].

V. Domestic building and loan associations organized and operated for mutual purposes and without profit are exempt [¶ 3100].

VI. Insurance companies claiming exemption as fraternal beneficiary societies [¶ 3101].

The special excise tax imposed under section 407 of the act of September 8, 1916, is very similar in some respects to the corporation-tax act of August 5, 1909, and therefore the following court decisions rendered under that act would apply to the present law:

I

When is a Corporation "Engaged in Business," "Doing Business," or "Transacting Business"?

Flint v. Stone Tracy Co., Cedar Street Co. v. Park Realty Co. and 13 other cases (220 U. S. 107; T. D. 1685)

In these cases it was held that section 38, act of August 5, 1909, imposing a special excise tax on corporations was constitutional, and further that corporations whose business is principally the holding and management of real estate are actively "engaged in business" within the meaning of that statute.

In the case of Cedar Street Co. v. Park Realty Co. it developed that the Park Realty Co. was organized to "work, develop, sell, convey, mortgage, or otherwise dispose of real estate; to lease, exchange, hire, or otherwise acquire property; to erect, alter, or improve buildings; to conduct, operate, manage, or lease hotels, apartment houses, etc.; to make and carry out contracts in the manner specified concerning buildings . . . and generally to deal in, sell, lease, exchange, or otherwise deal with lands, buildings, and other property, real or personal," etc.

The court, in its decision, used the following language:

We think it is clear that corporations organized for the purpose of doing business, and actually engaged in such activities as leasing property, collecting rents, managing office buildings, making investments of profits, or leasing ore lands and collecting royalties, managing wharves, dividing profits, and in some cases investing the surplus, are engaged in business within the meaning of this statute, and in the capacity necessary to make such organizations subject to the law.

Several good illustrations of what constitutes "engaging in business" are cited in the decision of the court in these cases.

Zonne v. Minneapolis Syndicate et al. (220 U. S. 187; T. D. 1687)—Peculiarity of corporate organization exempting it from special excise tax

Where a corporation originally organized for the purpose of owning and renting an office building leased the property for 130 years and reorganized and practically went out of business, its sole authority being to hold the

title subject to the lease and to receive and distribute the rentals accruing thereunder or the proceeds of sale if the property should be sold, held not liable to the special excise tax under section 38 of the act of August 5, 1909.

The court stated in this case as follows:

The corporation involved in the present case, as originally organized, and owning and renting an office building, was doing business within the meaning of the statute as we have construed it. Upon the record now presented we are of opinion that the Minneapolis syndicate, after the demise of the property and reorganization of the corporation, was not engaged in doing business within the meaning of the act. It had wholly parted with control and management of the property; its sole authority was to hold the title subject to the lease for 130 years, to receive and distribute the rentals which might accrue under the terms of the lease, or the proceeds of any sale of the land if it should be sold. The corporation had practically gone out of business in connection with the property and had disqualified itself by the terms of reorganization from any activity in respect to it. We are of opinion that the corporation was not doing business in such wise as to make it subject to the tax imposed by the act of 1909.

McCoach, collector, v. Minehill & Schuylkill Haven Railroad Co. (228 U. S. 295; T. D. 1847)

Leased railroads.—A railroad corporation, which has leased its property for a term of years and parted with its control and management, but which maintains its corporate organization and collects rentals from the lessee company and distributes the same among its stockholders, is not "engaged in business" within the meaning of the corporation-tax act of 1909 and is not liable for taxes thereunder, notwithstanding the lease provides for recovery of the property in case of default.

Corporations out of business.—When the corporation owning the property has gone out of business in connection therewith, and disqualified itself from any activity in regard to it, there is no liability, the principle being the same as that involved in the case of Zonne *v.* Minneapolis Syndicate (220 U. S. 187), which is held to govern this case.

The court stated in this case as follows:

From the facts as stated above it is entirely clear that the Minehill Co. was not, during the years 1909 and 1910, engaged at all in the business of maintaining or operating a railroad, which was the prime object of its incorporation. This business, by the lease of 1896, it had turned over to the Reading Co. If that lease had been made without authorization of law—it may be that for some purposes, and possibly, for the present purpose—the lessee might be deemed in law the agent of the lessor; or at least the lessor held estopped to deny such agency. But the lease was made by the express authority of the State that created the Minehill Co., conferred upon it its franchise, and imposed upon it the correlative public duties. The effect of this legislation and of the lease made thereunder was to constitute the Reading Co. the public agent for the operation of the railroad and to prevent the Minehill Co. from carrying on business in respect of the maintenance and

operation of the railroad so long as the lease shall continue. And it is the Reading Co., and not the Minehill Co., that is "doing business" as a railroad company upon the lines covered by the lease, and is taxable because of it. The corporation-tax law does not contemplate double taxation in respect of the same business.

United States v. Emery-Bird-Thayer Realty Co. (237 U. S. 28; T. D. 2188)

Engaged in business.—The lessor corporation was not carrying on or doing business within the meaning of the law, the only business done being keeping up its corporate organization and collecting and distributing rent received from lessee following the rule laid down in T. D. 1847.

The court states as follows:

Being of opinion that the District Court had jurisdiction, we pass to the merits. They also may be disposed of without much discussion. The line lies between Cedar Street Co. *v.* Park Realty Co. (220 U. S. 107, 170) and Zonne *v.* Minneapolis Syndicate (220 U. S. 187), the latter case being carried perhaps a little further by McCoach *v.* Minehill & Schuylkill Haven R. R. Co. (228 U. S. 295). We are of opinion that this case is governed by the last two and that the decision was right. The question is rather what the corporation is doing than what it could do (228 U. S. 205, 306), but looking even to its powers, they are limited very nearly to the necessary incidents of holding a specific tract of land. The possible sale of the whole would be merely the winding up of the corporation. That of a part would signify that the dry goods company did not need it. The claimants characteristic charter function and the only one that it was carrying on was the bare receipt and distribution to its stockholders of rent from a specified parcel of land. Unless its bare existence as an intermediary was doing business, it is hard to imagine how it could be less engaged.

Stratton's Independence (Ltd.) v. F. W. Howbert, collector (231 U. S. 399; T. D. 1913)

Mining companies.—Section 38, act of August 5, 1909, imposing a special excise tax on corporations applies to mining companies.

The court stated as follows:

It is not correct, from either the theoretical or the practical standpoint, to say that a mining corporation is not engaged in business, but is merely occupied in converting its capital assets form one form into another. The sale outright of a mining property might be fairly described as a mere conversion of the capital from land into money. But when a company is digging pits, sinking shafts, tunneling, drifting, stoping, drilling, blasting, and hoisting ores, it is employing capital and labor in transmuting a part of the realty into personalty and putting it into marketable form. The very process of mining is, in a sense, equivalent in its results to a manufacturing process. And, however the operation shall be described, the transaction is indubitably "business" within the fair meaning of the act of 1909; and the gains derived from it are properly and strictly from that business; for

"income" may be defined as the gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor. As to the alleged inequality of operation between mining corporations and others, it is of course true that the revenues derived from the working of mines result to some extent in the exhaustion of the capital. But the same is true of the earnings of the human brain and hand when unaided by capital, yet such earnings are commonly dealt with in legislation as income. . . . That mining companies are doing business, within the fair intent and meaning of this clause, seems to us entirely plain, for reasons already given.

Rio Grande Junction Railway Co. v. *United States, Case No. 32746, Court of Claims.* (*T. D. 2345.*) (*Decided May 26, 1916*)

The Minehill decision in the Supreme Court.—Decision in the Minehill case (228 U. S. 295; T. D. 1847) does not apply where a corporation is organized for the ostensible purpose of building and operating a railroad and leases the road before it is built.

Corporations organized to build and lease property.—If the purpose for which it was organized was to build and lease property, the rents derived from such lease are taxable, even though thereby the corporation leases all the property and of necessity goes out of all corporate business excepting the collection and distribution of the rents.

The court stated:

We do not think, however, the case presented by the plaintiff comes within the cases cited, for reasons which we will proceed to give. Its articles of incorporation show that it was designed as a junction company; that is to say, that it was intended as a connecting line between other lines named. The contract for a lease was executed within six months after the date of its articles of incorporation, and by its terms it may be well inferred that the lessees guaranteed the payment of all funds borrowed for its construction, and from the latter fact it may well be inferred that its construction was not begun until these bonds were issued and their payment guaranteed. It does does not appear that this company ever purchased or owned any rolling stock or anything pertaining to the operation of a railroad, except its track and appurtenances necessary for the use of rolling stock. As soon as said junction railroad was completed the lessees took possession of it and have been operating it ever since. Shortly after it was incorporated and before the execution of the agreement the General Assembly of Colorado authorized the plaintiff to lease its railroad (not then built), which must have been for the purpose of making doubly certain what the articles of incorporation already seemed to allow. These facts lead to but one conclusion, and that is that the "business" for which the plaintiff was incorporated was to build and lease a junction railroad and enjoy the profits of that business alone. It never equipped a railroad for use as such and never intended to, as all the facts show. If plaintiff is allowed to evade payment of the corporation tax in this way, we see no reason why this practice can not be followed in the construction hereafter of every railroad,

and thus evade the payment of a large percentage of the tax upon the net income of railway corporations.

There are cited below several decisions of the lower courts, construing the language of the Supreme Court in the above cases and further defining the terms "doing business," "engaged in business," and "transaction of business": Baumbach, collector, *v.* Sargent Land Co. *et al.* (219 Fed. 31), (now before the Supreme Court on writ of certiorari); Lewellyn, collector, *v.* Pittsburgh, B. & L. E. R. R. Co. *et al.* (222 Fed. 177); Miller, collector, *v.* Snake River Valley R. R. Co. (223 Fed. 946); Traction Co. *v.* Collectors of Internal Revenue (six cases) (233 Fed. 984), (decision of District Court printed in T. D. 2000 reversed); Waterbury Gaslight Co. *v.* Walsh (228 Fed. 54); McCoach, collector, *v.* Continental Passenger Railway Co. of Philadelphia (233 Fed. 976); State Line & S. R. Co. *v.* Davis (228 Fed. 246); Wilkes-Barre & W. V. Traction Co. *v.* Davis, collector (214 Fed. 511); Maxwell *v.* Abrast Realty Co. (218 Fed. 457); United States *v.* Nipissing Mines Co. (206 Fed. 431).

Corporations which are not "engaged in business," "doing business" or "transacting business," as construed under the language of the courts in the above decisions are not subject to the special excise tax imposed under section 407 of the act of September 8, 1916.

II

"Massachusetts Trusts" are Exempt from the Special Excise Tax

Eliot v. Freeman et al. (220 U. S. 178; T. D. 1686)

Intent of Congress.—It was the intention of Congress to embrace within the statute imposing a special excise tax on corporations only such corporations and joint-stock associations as are organized under some statute or derive from that source some quality or benefit not existing at the common law.

The court stated as follows:

The two cases now under consideration embrace trusts which do not derive any benefit from and are not organized under the statutory laws of Massachusetts. Joint-stock companies of the statutory character are not known to the laws of that Commonwealth. Ricker *v.* American Tea Co. (140 Mass. 346). These trusts do not have perpetual succession, but end with lives in being and 20 years thereafter.

Entertaining the view that it was the intention of Congress to embrace within the corporation-tax statute only such corporations and joint-stock associations as are organized under some statute or derive from that source some quality or benefit not existing at the common law, we are of opinion that the real-estate trusts involved in these two cases are not within the terms of the act. In that view the decrees in both cases will be reversed and the same remanded to the Circuit Court of the United States for the District of Massachusetts, with directions to overrule the demurrers and for further proceedings consistent with this opinion.

III

Necessity for the Filing of a Return

United States v. Military Construction Co. (204 Fed. 153; T. D. 1774)

Returns.—Corporations having a net income of $5,000 or less are not exempt from the requirement that a return be made to the collector of the district in which such corporation has its principal place of business.

The court stated as follows:

The return required is a somewhat complicated one. It consists of eight sections, the proper interpretation of which controls the determination of what the net income may be. This is a matter for the exercise of the official judgment and discretion of the revenue department. In order that it may exercise such judgment and discretion it must have the facts before it. The officers of the corporation and those of the revenue department may differ as to the ultimate effect of such facts.

This ruling with regard to filing returns is also laid down in United States v. Acorn Roofing Co. and four other corporations (204 Fed. 157; T. D. 1784).

IV

Foreign Corporations Transacting Business in the United States

Laurentide Co. (Ltd.) v. Durey, collector (231 Fed. 223; T. D. 2346)

Liability of foreign corporation—"Doing business"—"Transacting business"—"Engaged in business."—Under the revenue act of August 5, 1909, taxing the net income of foreign corporations engaged in business in the United States, and under the income-tax law of October 3, 1913, taxing such income of such corporations accruing from business transacted and capital invested within the United States, where a Canadian corporation making news print paper sent agents into the United States to solicit purchasers for its product, paying their expenses, hiring desk room in the United States, empowering the salesmen to make written contracts, in part in the United States, subject to the corporation's approval in Canada, and, when approved, to deliver the contracts, paying rent, storage charges on paper shipped into the United States, and also for work done by checks drawn on a bank in the United States where the company kept its funds received for goods delivered in the United States to purchasers, and then, to perform its written contracts, shipped paper consigned to itself in the United States to different points, where it hired storage rooms, and had the paper delivered to itself at such rooms, where it stored it in its own name and at its own risk pending delivery, doing so for its own convenience and to insure delivery according to contract, also shipping into the United States and storing in such manner paper to meet anticipated demands, such Canadian company "did business" in the United States, and "engaged in business" therein, and also "transacted business" in the United States, so that it was liable to taxation under both acts.

The court stated:

Appropriating the idea of Mr. Justice Peckham expressed in Pennsyl-

vania L. M. F. I. Co. v. Meyer (197 U. S. at p. 415; 25 Sup. Ct. 483; 42 L. Ed. 810), I think it would be somewhat difficult for the Laurentide Co. (Ltd.), or its able attorney, to describe what it was doing in the United States if it was not doing, carrying on, and transacting business therein when there receiving large quantities of news paper consigned to itself and storing it, hiring and paying for storage room therefor, delivering it to customers, purchasers thereof, soliciting contracts by agents for the purchase and supply of same, renting and paying rent for a room for doing the business, depositing and collecting the checks received in payment, and paying the expenses of the business therefrom, all done in the State of New York in the United States. It was not necessary that the contracts should have been made wholly in the United States. Pennsylvania Life Insurance Co. v. Meyer (197 U. S. 407, 414; 25 Sup. Ct. 483; 49 L. Ed. 810), or that their execution or performance should have been wholly in the United States.

V

Domestic Building and Loan Associations Organized and Operated for Mutual Purposes and Without Profit are Exempt

Herold, collector, v. Park View Building and Loan Association (210 Fed. 577; T. D. 1941)

Construction of clause.—The words "no part of the net income of which inures to the benefit of any private stockholder or individual" do not apply to domestic building and loan associations operated for the mutual benefit of members.

Exemption.—Building and loan associations operated exclusively for the mutual benefit of their members are exempt.

Issuance of prepaid stock.—The issuance of prepaid stock does not destroy mutuality (affirming 203 Fed. 876).

VI

Insurance Companies Claiming Exemption as Fraternal Beneficiary Societies

Commercial Travelers' Life and Accident Association v. Rodway, collector (235 Fed. 370; T. D. 1918)

Insurance companies.—The corporation in question is an insurance company within the meaning of the law and subject to the tax imposed by section 38, act of August 5, 1909.

Fraternal beneficiary societies.—There is no exemption in the law in favor of insurance companies other than fraternal beneficiary societies operating under the lodge system (see T. D. 1738). Fraternal beneficiary societies defined.

Inasmuch as the basis of tax is the fair value of the stock of a corporation, mutual insurance companies and other associations not having capital

stock represented by shares will also be exempt from tax, in the absence of a basis for the computation of the tax.

Respectfully,

W. H. OSBORN,
Commissioner of Internal Revenue.

Approved:
W. G. McADOO,
Secretary of the Treasury.

(T. D. 2423)

SPECIFIC RULINGS MADE BY THIS OFFICE IN ANSWER TO QUESTIONS ARISING UNDER THE SPECIAL EXCISE TAX IMPOSED BY SECTION 407 OF THE ABOVE ACT

I. ESTIMATING FAIR VALUE OF CAPITAL STOCK.
II. COMPUTING FAIR VALUE OF CAPITAL STOCK WHEN SALES HAVE BEEN MADE.
III. CHARACTER OF THE EXCISE TAX. CORPORATIONS LIABLE.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., December 30, 1916.

TO COLLECTORS OF INTERNAL REVENUE:

1. The following suggestions have been made regarding the method of estimating the fair value of stock under Case III, Item 6, on Form 707:

(*a*) Where the capital stock of a corporation is worth $100 per share par value and the corporation reports 10,000 shares, having a total value of $1,000,000, and also reports a surplus of $500,000, and undivided profits of $50,000, the book value of such stock would be $1,550,000. This should be taken as the basis of the approximate value of the stock per share ($155) unless by reason of earning capacity the real value is in excess of the book value, or unless for any reason the book value is fictitious and is shown by over-estimating the value of assets.

(*b*) If the "average profits per share earned during preceding five years" indicate an "estimated earning capacity" in excess of the book value, the fair value of the capital stock may be based upon a reasonable return on capital invested, dependent on the hazards of the business and what prices the stock of corporations engaged in a similar character of business brings in the open market.

(*c*) If the book value is fictitious and is shown by over-estimating the capital assets, this fact should be fully explained, either on the return or in a statement attached thereto, and may be given allowance in determining the fair value of stock where the "average profits per share earned during preceding five years" and "earning capacity" are exceedingly low.

(*d*) The "average dividends per share paid during preceding five years" are stated merely for the information of this office in a case where a corporation shows an earning capacity but states no surplus or undivided profits.

(*e*) One return submitted by a lumber company for examination showed a surplus of $257,700, but stated that it was "not earned." In view of the fact that the total profits of this company for the last four years of operation only amounted to $22,709.19, and it had paid no dividends within the last five years, and its earning capacity was practically nothing, the corporation was advised to file a statement, explaining how the surplus was acquired, and if it was real or fictitious owing to the inflated valuation of assets on the books. The fair value of the stock of this company, which was estimated on the return at par, $100 per share, would largely depend upon the value of its assets, especially the surplus of $257,700. In other words, if the capital stock of $450,000, the surplus of $257,700, and the undivided profits of $22,708.19, were divided up at the present time, would the corporation pay $162 per share to each of the stockholders, that being approximately the book value?

(*f*) A return filed by a Cotton Yarn Manufacturing Corporation showing average profits for the last five years of $15,949.45 on capital stock of $200,000, stated an estimated value under Case III of $70 per share. An industrial corporation of this character stating the fair value of its stock at $70 upon a return showing an earning capacity of seven to eight per cent., is considered fair, in view of the speculative character of its business.

(*g*) The Collectors may make notations at the foot of special lists, Form 23C, of any exceptional cases in which specific rulings of the Department are desired, and if it is necessary for this office to make an examination of the return, statements, or affidavits of officers of the corporation, the Collectors will be asked to forward them for that purpose.

(*h*) Where a holding company owns all the stock of several subsidiary corporations which is not listed on any exchange or which has not been sold in the last fiscal year, it has been held that the fair value of the stock of such subsidiary companies may be estimated from the market value of the total capital stock of the holding company (the parent corporation) by apportionment of the fair value of the total capital stock of the holding corporations among the subsidiary companies. This does not of course relieve the holding company from its liability to the special excise tax, the average fair value of the stock of which can probably be computed under Case I or II.

II. Corporations estimating the fair value of their stock under Case II, Item 6, on Form 707, will comply strictly with the provisions in the regulations by taking "the average price at which sales were made during the preceding fiscal year" and not the average selling price per share. Thus, if ten shares were sold at $100 and one thousand shares were sold at $70, the "average price at which sales were made" would be $85. The average selling price in such case would be $70.29, but this price will not be accepted as an average fair value. Corporations protesting against the computation of the value of stock on this basis may file a statement with the return on Form 707 setting forth the facts in detail and requesting the Collector to bring the case to the attention of this office by a notation on the special list, Form 23C, when it is forwarded to the Department for audit.

III. From correspondence reaching this office there appears to be a general

lack of understanding of the character and scope of the special excise tax imposed upon corporations by this act.

This tax is an excise tax on the privilege of doing business similar to occupational taxes imposed on individuals, except that instead of a flat tax the amount of tax is measured by the average value of the stock during the preceding year. Being a privilege or occupational tax, it is payable in advance for a period from the time the Act goes into effect to the end of the fiscal year and annually thereafter in July, the beginning of the Government's fiscal year. The tax is payable to the Collector at any time after Jan. 1, 1917, but penalties for non-payment do not attach until ten days after notice and demand therefor has been served by the Collector upon the tax-payer.

It is a condition precedent that the corporation to be liable must have been engaged in business during the preceding taxable (fiscal) year. This means, however, not that it must have been engaged in business during the entire year, but at some time in the year, and the length of time has no bearing upon the amount of tax due. That is found by ascertaining the actual average market value of the stock from known sales, or estimating such value for the preceding taxable year, which, in the case of the return due in Jan., 1917, is the Government's fiscal year from July 1, 1915, to June 30, 1916.

Respectfully,

G. E. FLETCHER,
Acting Commissioner.

APPENDIX D

SPECIAL EXCISE TAX ON CORPORATIONS [1]

ENACTED AUGUST 5, 1909

(REPEALED BY ACT OF OCTOBER 3, 1913)

SEC. 38. That every corporation, joint-stock company or association, organized for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States or of any State or Territory of the United States or under the Acts of Congress applicable to Alaska or the District of Columbia, or now or hereafter organized under the laws of any foreign country and engaged in business in any State or Territory of the United States or in Alaska or in the District of Columbia, shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint-stock company or association, or insurance company, equivalent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax hereby imposed; or if organized under the laws of any foreign country, upon the amount of net income over and above five thousand dollars received by it from business transacted and capital invested within the United States and its Territories, Alaska, and the District of Columbia during such year, exclusive of amounts so received by it as dividends upon stock of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax hereby imposed: *Provided, however*, That nothing in this section contained shall apply to labor, agricultural or horticultural organizations, or to fraternal beneficiary societies, orders, or associations operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders or associations, and dependents of such members, nor to domestic building and loan associations, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

Corporations Taxable.

Exempt.

[1] For reference to this law in the ascertainment of net income of corporations for prewar period (years 1911 and 1912) under the Excess Profits Tax Law, see page 122.

Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint-stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association or trust company, all interest actually paid by it within the year on deposits; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the government of any foreign country as a condition to carry on business therein; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint-stock companies or associations, or insurance companies, subject to the tax hereby imposed: *Provided*, That in the case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, such net income shall be ascertained by deducting from the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia, (first) all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States and its Territories, Alaska, and the District of Columbia, including all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year in business conducted by it within the United States or its Territories, Alaska, or the District of Columbia not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness, not exceeding the proportion of its paid-up capital stock outstanding at the close of the year which the gross amount of its in-

"Net Income" Defined.

Expenses, Losses.

Interest.

Taxes.

Dividends Received.

Foreign Corporations.

Expenses.

Losses.

Interest.

come for the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia bears to the gross amount of its income derived from all sources within and without the United States; (fourth) the sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint-stock companies or associations, and insurance companies, subject to the tax hereby imposed. In the case of assessment insurance companies the actual deposit of sums with State or Territorial office pursuant to law, as additions to guaranty or reserve funds shall be treated as being payments required by law to reserve funds.

Taxes.

Dividends Received.

Reserves.

Third. There shall be deducted from the amount of the net income of each of such corporations, joint-stock companies or associations, or insurance companies, ascertained as provided in the foregoing paragraphs of this section, the sum of five thousand dollars, and said tax shall be computed upon the remainder of said net income of such corporation, joint-stock company or association, or insurance company, for the year ending December thirty-first, nineteen hundred and nine, and for each calendar year thereafter; and on or before the first day of March, nineteen hundred and ten, and the first day of March in each year thereafter, a true and accurate return under oath or affirmation of its president, vice-president, or other principal officer, and its treasurer or assistant treasurer, shall be made by each of the corporations, joint-stock companies or associations, and insurance companies, subject to the tax imposed by this section, to the collector of internal revenue for the district in which such corporation, joint-stock company or association, or insurance company has its principal place of business, or, in the case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, in the place where its principal business is carried on within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth (first) the total amount of the paid-up capital stock of such corporation, joint-stock company or association, or insurance company, outstanding at the close of the year; (second) the total amount of the bonded and other indebtedness of such corporation, joint-stock company or association, or insurance company at the close of the year; (third) the gross amount of the income of such corporation, joint-stock company or association, or insurance company received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia; also the amount received by such corporation, joint-stock company or association, or insurance company within the year by way of dividends upon stock of other corporations, joint-stock companies or associa-

Exemption.

Due Date of Returns.

Oath.

Contents of Returns, Capital Stock, Indebtedness, Gross Income.

tions, or insurance companies, subject to the tax imposed by this section; (fourth) the total amount of all the ordinary and necessary expenses actually paid out of earnings in the maintenance and operation of the business and properties of such corporation, joint-stock company or association, or insurance company within the year, stating separately all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property, and if organized under the laws of a foreign country the amount so paid in the maintenance and operation of its business within the United States and its Territories, Alaska, and the District of Columbia; (fifth) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in the cases of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve fund; and in the case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, all losses actually sustained by it during the year in business conducted by it within the United States or its Territories, Alaska, and the District of Columbia, not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve fund; (sixth) the amount of interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint-stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association, or trust company, stating separately all interest paid by it within the year on deposits; or in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, interest so paid on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States and any of its Territories, Alaska, and the District of Columbia, bears to the gross amount of its income derived from all sources within and without the United States; (seventh) the amount paid by it within the year for taxes imposed under the authority of the United States or any State or Territory thereof, and separately the amount so paid by it for taxes imposed by the government of any foreign country as a condition to carrying on business therein; (eighth) the net income of such corporation, joint-stock company or association, or insurance company, after making the deductions in this section authorized. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue.

Expenses.

Losses.

Reserve Funds.

Interest.

Taxes.

Fourth. Whenever evidence shall be produced before the Commissioner of Internal Revenue which in the opinion of the commissioner justifies the belief that the return made by any corporation, joint-stock company or association, or insurance company is incorrect, or whenever any collector shall report to the Commissioner of Internal Revenue that any corporation, joint-stock company or association, or insurance company has failed to make a return as required by law, the Commissioner of Internal Revenue may acquire from the corporation, joint-stock company or association, or insurance company making such return, such further information with reference to its capital, income, losses, and expenditures as he may deem expedient; and the Commissioner of Internal Revenue, for the purpose of ascertaining the correctness of such return or for the purpose of making a return when none has been made, is hereby authorized, by any regularly appointed revenue agent specially designated by him for that purpose, to examine any books and papers bearing upon the matters required to be included in the return of such corporation, joint-stock company or association, or insurance company, and to require the attendance of any officer or employee of such corporation, joint-stock company or association, or insurance company, and to take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons; and the Commissioner of Internal Revenue may also invoke the aid of any court of the United States having jurisdiction to require the attendance of such officers or employees and the production of such books and papers. Upon the information so acquired the Commissioner of Internal Revenue may amend any return or make a return where none has been made. All proceedings taken by the Commissioner of Internal Revenue under the provisions of this section shall be subject to the approval of the Secretary of the Treasury.

Verifying Returns.

Examination.

Returns by Department.

Fifth. All returns shall be retained by the Commissioner of Internal Revenue, who shall make assessments thereon; and in case of any return made with false or fraudulent intent, he shall add one hundred per centum of such tax, and in case of a refusal or neglect to make a return or to verify the same as aforesaid he shall add fifty per centum of such tax. In case of neglect occasioned by the sickness or absence of an officer of such corporation, joint-stock company or association, or insurance company, required to make said return, or for other sufficient reason, the collector may allow such further time for making and delivering such return as he may deem necessary, not exceeding thirty days. The amount so added to the tax shall be collected at the same time and in the same manner as the tax originally assessed, unless the refusal, neglect, or falsity is discovered after the date for payment of said taxes, in which case the amount so added shall be paid by the delinquent corporation, joint-stock company or association, or insurance company, immediately upon notice given by the collector. All assessments shall be made and the several corporations, joint-stock companies or associations, or insurance companies, shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments

Penalties, False Intent.

shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as above provided for, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due.

Discovery Limitation.

Penalty Delayed Payment.

Sixth. When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such.

Public Record.

Seventh. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or make known in any manner whatever not provided by law to any person any information obtained by him in the discharge of his official duty, or to divulge or make known in any manner not provided by law any document received, evidence taken, or report made under this section except upon the special direction of the President; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding one thousand dollars, or by imprisonment not exceeding one year, or both, at the discretion of the court.

Divulging Contents of Returns.

Penalty.

Eighth. If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid, shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not less than one thousand dollars and not exceeding ten thousand dollars.

Refusal to Make Return Penalty.

Any person authorized by law to make, render, sign, or verify any return who makes any false or fraudulent return, or statement, with intent to defeat or evade the assessment required by this section to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding one thousand dollars or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

False Return Penalty.

All laws relating to the collection, remission, and refund of internal-revenue taxes, so far as applicable to and not inconsistent with the provisions of this section, are hereby extended and made applicable to the tax imposed by this section.

Collections.

Jurisdiction is hereby conferred upon the circuit and district courts of the United States for the district within which any person summoned under this section to appear to testify or to produce books as aforesaid, shall reside, to compel such attendance, production of books, and testimony by appropriate process. Jurisdiction of Courts.

APPENDIX E

EXTRACTS FROM FEDERAL INCOME TAX[1] RELATING TO CORPORATIONS

ENACTED OCTOBER 3, 1913

(REPEALED BY ACT OF SEPTEMBER 8, 1916)

G. (a) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships; but if organized, authorized, or existing under the laws of any foreign country, then upon the amount of net income accruing from business transacted and capital invested within the United States during such year: *Provided, however*, That nothing in this section shall apply to labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members, nor to domestic building and loan associations, nor to cemetery companies, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, nor to business leagues, nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; nor to any civic league or organization not organized for profit, but operated exclusively for the promotion of social welfare: *Provided further*, That there shall not be taxed under this section any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia,

Domestic Corporations.

Foreign Exempt.

Public Utility.

[1] Official Title of the law: "Tariff Act of Oct. 3, 1913." For reference to this law in the ascertainment of net income of corporations for the prewar period (year 1913) see page 122.

or any political subdivision of a State, Territory, or the District of Columbia, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico: *Provided*, That whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this Act, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate or maintain a public utility, no tax shall be levied under the provisions of this Act upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this section upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

(b) Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any; and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual

"Net Income" Defined.

Expenses.

Losses.

Depletion.

Reserve.

Insurance Companies.

policyholder, or treated as an abatement of premium of such individual policyholder, within such year; (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year: *Provided*, That in case of indebtedness wholly secured by collateral the subject of sale in ordinary business of such corporation, joint-stock company, or association, the total interest secured and paid by such company, corporation, or association, within the year on any such indebtedness may be deducted as a part of its expense of doing business: *Provided further*, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; and in the case of a bank, banking association, loan, or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country: *Provided*, That in the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount of its income accrued within the year from business transacted and capital invested within the United States, (first) all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year in business conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any, and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the

Interest.

Taxes.

Foreign Corporations.

Expenses.

Losses.

Depletion.

Insurance Companies.

companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policy-holders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policy-holder as shall have been paid back or credited to such individual policy-holder, or treated as an abatement of premium of such individual policy-holder, within such year; (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding the proportion of one-half of the sum of its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital employed in the business at the close of the year which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States: *Provided*, That in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof or the District of Columbia. In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds.

Interest.

Taxes.

(*c*) The tax herein imposed shall be computed upon its entire net income accrued within each preceding calendar year ending December thirty-first: *Provided, however*, That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be imposed upon its entire net income accrued within that portion of said year from March first to December thirty-first, both dates inclusive, to be ascertained by taking five-sixths of its entire net income for said calender year: *Provided further*, That any corporation, joint-stock association, or insurance company subject to this tax may designate the last day of any month in the year as the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for the calendar year preceding the date of assessment; and it shall give notice of the day it has thus designated as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the date upon which

Ten Months of 1913.

Designated Fiscal Year.

its annual return shall be filed. All corporations, joint-stock companies or associations, and insurance companies subject to the tax herein imposed,

Due Date of Return.

computing taxes upon the income of the calendar year, shall, on or before the first day of March, nineteen hundred and fourteen, and the first day of March in each year thereafter, and all corporations, joint-stock companies or associations, and insurance companies, computing taxes upon the income of a fiscal year which it may designate in the manner hereinbefore provided, shall render a like return within sixty days after the close of its said fiscal year, and within sixty days after the close of its fiscal year in each year thereafter, or in the case of a corporation, joint-stock company or association, or insurance company, organized or

Returns. Oath.

existing under the laws of a foreign country, in the place where its principal business is located within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, shall render a true and accurate return under oath or affirmation of its president, vice president, or other

Capital Stock.

principal officer, and its treasurer or assistant treasurer, to the collector of internal revenue for the district in which it has its principal place of business, setting forth (first) the total amount of its paid-up capital stock outstanding, or if no capital stock is capital employed in business, at the close of the year; (second) the total amount of its bonded and other indebtedness at the close of the year; (third) the gross amount

Indebtedness.

of its income, received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within the year from business transacted and

Expenses.

capital invested within the United States; (fourth) the total amount of all its ordinary and necessary expenses paid out of earnings in the maintenance and operation of the business and properties of such corporation, joint-stock company or association, or insurance company within the year, stating separately all rentals or other payments required to be made as a condition to the continued use or possession of property, and if organized under the laws of a foreign country the amount so paid in the maintenance and operation of its business within the United States; (fifth) the total amount of all losses actually sustained during the

Losses.

year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members

Insurance Companies.

to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received

by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; and in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, all losses actually sustained by it during the year in business conducted by it within the United States, not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; (sixth) the amount of interest accrued and paid within the year on its bonded or other indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock, outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of indebtedness not exceeding the amount of capital employed in the business at the close of the year, and in the case of a bank, banking association, or trust company, stating separately all interest paid by it within the year on deposits; or in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, interest so paid on its bonded or other indebtedness to an amount of such bonded or other indebtedness not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of capital employed in the business at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and

Interest.

without the United States; (seventh) the amount paid by it within the year for taxes imposed under the authority of the United States and separately the amount so paid by it for taxes imposed by the Government of any foreign country; (eighth) the net income of such corporation, joint-stock company or association, or insurance company, after making the deductions in this subsection authorized. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue.

Taxes.

All assessments shall be made, and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or before the thirtieth day of June: *Provided*, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and twenty days after the date upon which it is required to file its list or return of income for assessment; except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, or after one hundred and twenty days from the date on which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the collector, there shall be added the sum of 5 per centum on the amount of tax unpaid and interest at the rate of 1 per centum per month upon said tax from the time the same becomes due.

Due Date Payment.

Refusal, Neglect.

(d) When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President: *Provided further*, That the proper officers of any State imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint-stock company, association or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe.

Assessments.

If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid, shall refuse or neglect to make a return at

the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding $10,000. **Penalty, Fraud.**

H. That the word "State" or "United States" when used in this section shall be construed to include any Territory, Alaska, the District of Columbia, Porto Rico, and the Philippine Islands, when such construction is necessary to carry out its provisions. **"United States."**

APPENDIX F

TABLE OF ADDITIONAL TAXES (SURTAXES) IMPOSED UPON INDIVIDUALS BY INCOME TAX

ACT OF OCTOBER 3, 1913 ("TARIFF ACT") [1]

(REPEALED BY ACT OF SEPTEMBER 8, 1916)

Upon the amount by which the total net income exceeds:

		Per Annum
$20,000	and does not exceed $50,000	1 per cent.
50,000	" " 75,000	2 " "
75,000	" " 100,000	3 " "
100,000	" " 250,000	4 " "
250,000	" " 500,000	5 " "
and in excess of $500,000		6 " "

[1] For present application of surtaxes under this law, see "Dividends," page 23.

APPENDIX G

NEW YORK STATE INCOME TAX ON MANUFACTURING AND MERCANTILE CORPORATIONS

ENACTED JUNE 4, 1917

AN ACT

TO AMEND THE TAX LAW, IN RELATION TO A FRANCHISE TAX ON MANUFACTURING AND MERCANTILE CORPORATIONS, AND MAKING APPROPRIATIONS FOR ADMINISTRATION EXPENSES.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. Chapter sixty-two of the laws of nineteen hundred and nine, entitled "An act in relation to taxation, constituting chapter sixty of the consolidated laws," is hereby amended by inserting therein a new article, to be article nine-a, to read as follows:

ARTICLE 9-A

FRANCHISE TAX ON MANUFACTURING AND MERCANTILE CORPORATIONS

Sec. 208. Definitions.
209. Franchise tax on corporations based on net income.
210. Corporations exempt from article.
211. Reports of corporations to tax commission.
212. Reports by corporation on basis of fiscal year.
213. Reports to be sworn to; forms.
214. Computation of tax.
215. Rate of tax.
216. Penalty for failure to report.
217. Powers of tax commission.
218. Revision and readjustment of accounts by tax commission.
219. Review or determination of tax commission by certiorari.
219a. Audit and statement of tax.
219b. Notice of tax.
219c. When tax payable.
219d. Corrections and changes.
219e. Warrant for the collection of taxes.
219f. Action for recovery of taxes; forfeiture of charter by delinquent corporations.
219g. Deposit of revenues collected.
219h. Disposition of revenues collected.

Sec. 219i. Secrecy required of officials; penalty for violation.
219j. Manufacturing and mercantile corporations exempt from personal property tax and from the provisions of sections twelve, twenty-seven, one hundred and eighty-two and one hundred and ninety-two of the tax law.
219k. Limitation of time.

§ 208. DEFINITIONS. As used in this article. 1. The term "corporation" includes a joint-stock company or association;

2. The words "tangible personal property" shall be taken to mean corporeal personal property, such as machinery, tools, implements, goods, wares and merchandise, and shall not be taken to mean money, deposits in bank, shares of stock, bonds, notes, credits or evidences of an interest in property and evidences of debt;

3. The term "manufacturing corporation" means a corporation principally engaged in the business of manufacturing tangible personal property for itself or for others;

4. The term "mercantile corporation" means a corporation principally engaged in the business of buying or selling tangible personal property for itself or for others.

§ 209. FRANCHISE TAX ON CORPORATIONS BASED ON NET INCOME. For the privilege of exercising its franchises in this state in a corporate or organized capacity every domestic manufacturing and every domestic mercantile corporation, and for the privilege of doing business in this state, every foreign manufacturing and every foreign mercantile corporation, except corporations specified in the next section, shall annually pay in advance for the year beginning November first next preceding an annual franchise tax, to be computed by the tax commission upon the basis of its net income for its fiscal or the calendar year next preceding, as hereinafter provided, upon which income such corporation is required to pay a tax to the United States.

§ 210. CORPORATIONS EXEMPT FROM ARTICLE. Corporations liable to a tax under section one hundred and eighty-four of this chapter, corporations owning or operating elevated railroads or surface railroads not operated by steam, or formed for supplying water or gas or for electric or steam heating, lighting or power purposes and liable to a tax under sections one hundred and eighty-five and one hundred and eighty-six of this chapter, shall be exempt from the payment of the taxes prescribed by this article.

§ 211. REPORTS OF CORPORATIONS TO TAX COMMISSION. Every corporation taxable under this article as well as foreign corporations having officers, agents or representatives within the state shall annually on or before July first transmit to the tax commission a report in the form prescribed by the tax commission specifying: 1. The name and location of the principal place of business of such corporation, the state under the laws of which organized, and the date thereof; the kind of business transacted.

2. The amount of its net income for its preceding fiscal or the preceding calendar year as shown in the last return of annual net income made by it to the United States treasury department.

3. The average monthly value for the fiscal or calendar year of its real property and tangible personal property in each city, village or portion of a

town outside of a village within the state, and the average monthly value of all its real property and tangible personal property wherever located.

4. The average monthly value for the fiscal or calendar year of bills and accounts receivable for (a) tangible personal property sold from its stores or stocks within the state, (b) tangible personal property manufactured or shipped from within the state and (c) services performed within the state, and the average monthly total value for the fiscal or calendar year of bills and accounts receivable for (a) tangible personal property sold from its stores or stocks within and without the state, (b) tangible personal property manufactured or shipped from within the state and other states and countries, and (c) services performed both within and without the state.

5. The average total value for the fiscal or calendar year of the stock of other corporations owned by the corporation, and the proportion of the average value of the stock of such other corporations within the state of New York, as allocated pursuant to section two hundred and fourteen of this chapter.

6. If the corporation has no real or tangible personal property within the state, the city, village or portion of a town outside of a village in the state in which is located the office in which its principal financial concerns within the state are transacted.

7. Such other facts as the tax commission may require for the purpose of making the computation required by this article.

8. Any corporation taxable hereunder may omit from its report the statements required by subdivisions three to seven, both inclusive, by incorporating in its report a consent to be taxed upon its entire net income.

§ 212. Reports by Corporation on Basis of Fiscal Year. A corporation which reports to the United States treasury department on the basis of its fiscal year, may report to the tax commission upon the same basis.

§ 213. Reports to be Sworn to; Forms. Every report required by this article shall have annexed thereto the affidavit of the president, vice-president, secretary or treasurer of the corporation to the effect that the statements contained therein are true. Blank forms of report shall be furnished by the tax commission, on application, but failure to secure such a blank shall not release any corporation from the obligation of making a report herein required. The commission may require a further or supplemental report under this article to contain further information and data necessary for the computation of the tax herein provided.

§ 214. Computation of Tax. If the entire business of the corporation be transacted within the state, the tax imposed by this article shall be based upon the entire net income of such corporation as returned to the United States treasury department for such fiscal or calendar year.

If the entire business of such corporation be not transacted within the state, the tax imposed by this article shall be based upon a proportion of the net income, to be determined in accordance with the following rules:

The proportion of the net income of the corporation upon which the tax under this article shall be based, shall be such portion of the entire net income as the aggregate of

1. The average monthly value of the real property and tangible personal property within the state,

2. The average monthly value of bills and accounts receivable for (a) tangible personal property sold from its stores or stocks within the state, (b) tangible personal property manufactured or shipped from within the state and (c) services performed within the state,

3. The proportion of the average value of the stocks of other corporations owned by the corporation, allocated to the state as provided by this section,

Bears to the aggregate of

4. The average monthly value of all the real property and tangible personal property of the corporation, wherever located,

5. The average total value of bills and accounts receivable for (a) tangible personal property sold from its stores or stocks within and without the state, (b) tangible personal property manufactured or shipped from within this and other states and countries, and (c) services performed both within and without this state,

6. The average total value of the stocks of other corporations owned by the corporation.

Real property and tangible personal property shall be taken at its actual value where located. The value of share stock of another corporation owned by a corporation liable hereunder shall for purposes of allocation of assets be apportioned in and out of the state in accordance with the value of the physical property in and out of the state representing such share stock.

§ 215. RATE OF TAX. The tax imposed by this article shall be at the rate of three per centum of the net income of the corporation or portion thereof taxable within the state, determined as provided by this article.

§ 216. PENALTY FOR FAILURE TO REPORT. Any corporation which fails to make any report required by this article shall be liable to a penalty of not more than five thousand dollars to be paid to the state, to be collected in a civil action, at the instance of the tax commission; and any officer of any such corporation who makes a fraudulent return or statement with intent to defeat or evade the payment of the taxes prescribed by this article shall be liable to a penalty of not more than one thousand dollars, to be collected in like manner. All moneys recovered as penalties, for a failure to report or for making fraudulent reports shall be paid to the state comptroller.

§ 217. POWERS OF TAX COMMISSION. The tax commission may for good cause shown extend the time within which any corporation is required to report by this article. If any report required by this article be not made as herein required, the tax commission is authorized to make an estimate of the net income of such corporation and of the amount of tax due under this article, from any information in its possession, and to order and state an account according to such estimate for the taxes, penalties and interest due the state from such corporation. If the tax imposed upon any corporation under this article is based upon an estimate as provided in this section, the tax commission shall notify such corporation of a time and place

at which opportunity will be given to the corporation to be heard in respect thereof. Such notice shall be mailed to the post-office address of the corporation. All the authority and powers conferred on the tax commission by the provisions of section one hundred and ninety-five of the tax law shall have full force and effect in respect of corporations which may be liable hereunder.

§ 218. Revision and Readjustment of Accounts by Tax Commission. If an application for revision be filed with the commission by a corporation against which an account is audited and stated within one year from the time any such account shall have been audited and stated, the commission shall grant a hearing thereon and if it shall be made to appear upon any such hearing by evidence submitted to it or otherwise, that any such account included taxes or other charges which could not have been lawfully demanded, or that payment has been illegally made or exacted of any such account, the commission shall resettle the same according to law and the facts, and adjust the account for taxes accordingly, and shall send notice of its determination thereon to the corporation and state comptroller forthwith.

§ 219. Review of Determination of Tax Commission by Certiorari. The determination of the commission upon any application made to it by any corporation for revision and resettlement of any account, as prescribed in this article, may be reviewed in the manner prescribed by and subject to the provisions of sections one hundred and ninety-nine and two hundred of this chapter.

§ 219a. Audit and Statement of Tax. On or before the first day of November in each year the tax commission shall audit and state the account of each corporation known to be liable to a tax under this article, for its preceding fiscal or the preceding calendar year, and shall compute the tax thereon and forthwith notice the same to the state comptroller for collection. The tax commission shall determine the portion of such tax to be distributed to the several counties and the amounts to be credited to the several cities or towns thereof, when the same is collected, and shall indicate such determination in noticing such tax to the state comptroller. If the corporation has real property or tangible personal property located in a village, or if it has no real or tangible personal property in the state but the office in which its principal financial concerns within the state are transacted is located in a village, the tax commission shall indicate such facts to the state comptroller, with the name of the village in which such office or property is located.

§ 219b. Notice of Tax. Every report required by section two hundred and eleven of this chapter shall contain the post-office address of the corporation and lines or spaces upon which the corporation shall enter the portion of its net income which it believes to be the basis upon which the tax shall be imposed under this article, and the amount of such tax. Notice of tax assessment shall be sent by mail to the post-office address given in the report, and the record that such notice has been sent shall be presumptive evidence of the giving of the notice and such record shall be preserved by the tax commission.

§ 219c. WHEN TAX PAYABLE. The tax hereby imposed shall be paid to the state comptroller on or before the first day of January of each year. If such tax be not paid on or before January first, or in the case of additional taxes, within thirty days after the bill for such additional tax has been rendered, the corporation liable to such tax shall pay to the state comptroller, in addition to the amount of such tax, ten per centum of such amount, plus one per centum for each month the tax remains unpaid. Each such tax shall be a lien upon and binding upon the real and personal property of the corporation liable to pay the same from the time when it is payable until the same is paid in full.

§ 219d. CORRECTIONS AND CHANGES. If the amount of the annual net income of any corporation taxable under this article as returned to the United States treasury department is changed or corrected by the commissioner of internal revenue or other officer of the United States or other competent authority, such corporation, within ten days after receipt of notice of such change or correction, shall make return under oath or affirmation to the tax commission of such changed or corrected net income. The tax commission shall compute the taxes which, in view of such change or correction, would be due from such corporation for the fiscal or calendar year for which such change or correction is made. If from such computation it appear that such corporation shall have paid under this article an excess of tax for the year for which such computation is made, the tax commission shall return a statement of the amount of such excess to the comptroller, who shall credit such corporation with such amount. Such credit may be assigned by the corporation in whose favor it is allowed to a corporation liable to pay taxes under this article, and the assignee of the whole or any part of such credit on filing with the commission such assignment shall thereupon be entitled to credit upon the books of the comptroller for the amount thereof on the current account for taxes of such assignee in the same way and with the same effect as though the credit had originally been allowed in favor of such assignee. If from such computation it appear that an additional tax is due from such corporation for such fiscal or calendar year, such corporation shall, within thirty days after notice has been given as provided in section two hundred and nineteen b of this chapter by the tax commission, pay such additional tax.

§ 219e. WARRANT FOR THE COLLECTION OF TAXES. If the tax imposed by this article be not paid within thirty days after the same becomes due, unless an appeal or other proceeding shall have been taken to review the same, the comptroller may issue a warrant under his hand and official seal directed to the sheriff of any county of the state commanding him to levy upon and sell the real and personal property of the corporation owning the same, found within his county, for the payment of the amount thereof, with the added penalties, interest and the cost of executing the warrant, and to return such warrant to the comptroller and pay to him the money collected by virtue thereof by a time to be therein specified, not less than sixty days from the date of the warrant. Such warrant shall be a lien upon and shall bind the real and personal property of the corporation against whom it is issued from the time an actual levy shall be made by virtue thereof. The

sheriff to whom any such warrant shall be directed shall proceed upon the same in all respects, with like effect, and in the same manner as prescribed by law in respect to executions issued against property upon judgments of a court of record, and shall be entitled to the same fees for his services in executing the warrant, to be collected in the same manner.

§ 219f. Action for Recovery of Taxes; Forfeiture of Charter by Delinquent Corporations. Action may be brought at any time by the attorney-general at the instance of the comptroller, in the name of the state, to recover the amount of any taxes, penalties and interest due under this article. If such taxes be not paid within one year after the same be due, and the comptroller is satisfied that the failure to pay the same is intentional he shall so report to the attorney-general, who shall immediately bring an action in the name of the people of the state, for the forfeiture of the charter or franchise of any corporation failing to make such payment, and if it be found that such failure was intentional, judgment shall be rendered in each action for the forfeiture of such charter and for its dissolution if a domestic corporation and if a foreign corporation for the annulment of its franchise to do business in this state.

§ 219g. Deposit of Revenues Collected. The state comptroller shall deposit all taxes, interest and penalties collected under this article in responsible banks, banking houses or trust companies in the state which shall pay the highest rate of interest to the state for such deposit, to the credit of the state comptroller on account of the franchise tax. And every such bank, banking house or trust company shall execute and file in his office an undertaking to the state, in the sum, and with such sureties, as are required and approved by the comptroller, for the safe keeping and prompt payment on legal demand therefor of all such moneys held by or on deposit in such bank, banking house or trust company, with interest thereon on daily balances at such rate as the comptroller may fix. Every such undertaking shall have indorsed thereon, or annexed thereto, the approval of the attorney-general as to its form. The state comptroller shall on the first day of each month make a verified return to the state treasurer of all revenues received by him under this article during the preceding month, stating by whom and when paid, and shall credit himself with all payments made to county treasurers since his last previous return pursuant to section two hundred and nineteen h of this chapter.

§ 219h. Disposition of Revenues Collected. The state comptroller shall on or before the tenth day of each month pay into the state treasury to the credit of the general fund two-thirds of all taxes, interest and penalties received by him under this article during the preceding month, as appears from the return made by him to the state treasurer. The balance of all taxes, interest and penalties collected and received by him under this article from any corporation, as appears from the return made by him to the state treasurer, shall, on or before the tenth day of April, July, October and January, for the quarter ending with the last day of the preceding month, be distributed and paid by him to the treasurers of the several counties of the state and disposed of by such treasurers, in accordance with the following rules:

1. If the corporation has no real property or tangible personal property within the state, such payment shall be made to the county treasurer of the county in which is located the office at which its principal financial concerns within the state are transacted;

2. If the corporation has real property or tangible personal property, as shown by its report pursuant to section two hundred and eleven, in but one city or town of the state, such payment shall be made to the county treasurer of the county in which such city or town is located;

3. If the corporation has real property or tangible personal property in more than one city or town of the state, as shown by its report pursuant to section two hundred and eleven, such payment shall be made to the county treasurers of the counties in which such cities or towns are located in the proportion that the average monthly value of the real property and tangible personal property of such corporation in the cities and towns of such county bears to the average monthly value of all its real property and tangible personal property within the state;

4. In making such payment to a county treasurer, the state comptroller shall indicate the portion thereof to be credited to any city or town within the county on account of the location therein of its principal financial office or property as determined by the preceding subdivisions, and if such principal financial office or property is located in a village shall indicate the village in which it is located; if such principal financial office or property located in a city or in a town outside of a village, the whole of such portion shall be paid to such city or town as hereinafter provided; if such principal financial office or property is located in a village, there shall be paid to such village as hereinafter provided so much of such portion credited to the town as the assessed valuation of the real and personal property in such village or portion thereof in such town as appears by the last preceding town assessment-roll bears to twice the total assessed valuation of the real and personal property in such town as appears by such assessment-roll;

5. As to any county wholly included within a city such payment shall be made to the chamberlain or other chief fiscal officer of such city and be paid into the general fund for city purposes;

6. As to any county not wholly included within a city the county treasurer shall within ten days after the receipt thereof pay to the chief fiscal officer of a city or to the chief fiscal officer of a village or to the supervisor of a town the portion of money received by him from the state comptroller to which such city, village or town is entitled, which shall be credited by such officer to general city, village or town purposes.

§ 219i. Secrecy Required of Officials; Penalty for Violation. 1. Except in accordance with proper judicial order or as otherwise provided by law, it shall be unlawful for any tax commissioner, agent, clerk or other officer or employee to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report under this article. Nothing herein shall be construed to prohibit the publication of statistics so classified as to prevent the identification of particular reports and the items thereof, or the publication of delinquent lists showing the names of taxpayers who have failed to pay their taxes at the time and in

the manner provided by section two hundred and nineteen-c together with any relevant information which in the opinion of the comptroller may assist in the collection of such delinquent taxes; or the inspection by the attorney-general or other legal representatives of the state of the report of any corporation which shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted in accordance with the provisions of sections two hundred and sixteen or two hundred and nineteen-f of this article.

Reports shall be preserved for three years, and thereafter until the state tax commission orders them to be destroyed.

2. Any offense against the foregoing provision shall be punished by a fine not exceeding one thousand dollars or by imprisonment not exceeding one year, or both, at the discretion of the court and if the offender be an officer or employee of the state he shall be dismissed from office and be incapable of holding any public office in this state for a period of five years thereafter.

§ 219j. MANUFACTURING AND MERCANTILE CORPORATIONS EXEMPT FROM PERSONAL PROPERTY TAX AND FROM THE PROVISIONS OF SECTIONS TWELVE, TWENTY-SEVEN, ONE HUNDRED AND EIGHTY-TWO AND ONE HUNDRED AND NINETY-TWO OF THE TAX LAW. After this article takes effect manufacturing and mercantile corporations shall not be assessed on any personal property which for the purpose of this exemption shall include such machinery and equipment affixed to the building as would not pass between grantor and grantee as a part of the premises if not specifically mentioned or referred to in the deed, or as would, if the building were vacated or sold, or the nature of the work carried on therein changed, be moved, except boilers, ventilating apparatus, elevators, gas, electric and water power generating apparatus and shafting. After this article takes effect manufacturing and mercantile corporations shall not be assessed or taxed upon their capital stock as provided for in section twelve of this chapter, nor shall they be required to pay the franchise tax imposed by section one hundred and eighty-two of this chapter, nor to make the reports called for in sections twenty-seven and one hundred and ninety-two of this chapter. Nothing herein shall be construed to impair the obligation to pay franchise taxes due on or before the fifteenth day of January, nineteen hundred and seventeen, or taxes on personal property or capital stock assessed in the year nineteen hundred and sixteen or in the year nineteen hundred and seventeen before this article takes effect, whether payable in that year or not. But if any manufacturing or mercantile corporation shall pay taxes on personal property or capital stock assessed in any tax district in the year nineteen hundred and seventeen, such corporation shall be entitled to credit for the amount of such taxes so paid on its account for taxes first assessed against it under this article by the tax commission, not exceeding, however, the amount of such first assessment.

§ 219k. LIMITATION OF TIME. The provisions of the code of civil procedure relative to the limitation of time of enforcing a civil remedy shall not apply to any proceeding or action taken to levy, appraise, assess, determine or enforce the collection of any tax or penalty prescribed by this article.

§ 2. The sum of forty thousand dollars ($40,000) or so much thereof as

may be needed is hereby appropriated to the state comptroller for the expenses to be incurred by him in administering the provisions of this act; and the sum of seventy-five thousand dollars ($75,000) or so much thereof as may be needed is hereby appropriated to the state tax department for the expenses to be incurred by such department in administering the provisions of this act.

§ 3. This act shall take effect immediately.

TABLE OF CASES

PAGE

Anderson *vs.* Forty-two Broadway Co. (209 Fed. 991 and 213 Fed. 777) 104
Baldwin Locomotive Works *vs.* McCoach (221 Fed. 59).....106, 130, 187
Baumbach *vs.* Sargent Land Co. (219 Fed. 31)..... 299
Brady *vs.* Anderson (240 Fed. 665)..... 82
Cedar Street Co. *vs.* Park Realty Co. (T. D. 1685)..... 295
Cohen *vs.* Lowe (234 Fed. 474)..... 178
Commercial Travelers' Life and Accident Assoc'n *vs.* Rodway (235 Fed. 370)..... 301
Edwards *vs.* Keith (224 Fed. 585 and 231 Fed. 110)..... 39
Eliot *vs.* Freeman (220 U. S. 178)..... 299
Flint *vs.* Stone Tracy Co. (220 U. S. 107)..... 295
Grand Rapids & Indiana Ry. Co. *vs.* Doyle (T. D. 2210)..... 102
Herold *vs.* Park View Building & Loan Assoc'n (210 Fed. 577)..... 301
Laurentide Co. (Ltd.) *vs.* Durey (231 Fed. 223)..... 300
Lewellyn *vs.* Pittsburgh, B. & L. E. R. R. Co. (222 Fed. 177)..... 299
McCoach *vs.* Continental Passenger Ry. Co. of Phila. (233 Fed. 976).. 299
McCoach *vs.* Minehill & Schuylkill Haven R. R. Co. (228 U. S. 295).. 296
Maxwell *vs.* Abrast Realty Co. (218 Fed. 457)..... 299
Middlesex Banking Co. *vs.* Eaton (221 Fed. 86)..... 204
Miller *vs.* Snake River Valley R. R. Co. (223 Fed. 946)..... 299
Mitchell Bros. *vs.* Doyle (225 Fed. 437)..... 130
Mutual Benefit Life Insurance Co. *vs.* Herold (198 Fed. 199)..... 180
P. & O. Steam Navigation Co. *vs.* Leslie (82 L. T. 137; 4 Tax Cas. 177 Eng.)..... 192
Pennsylvania Life Insurance Co. *vs.* Meyer (197 U. S. 407; 25 Sup. Ct. 483; 49 L. Ed. 810)..... 301
Ricker *vs.* American Tea Co. (140 Mass. 346)..... 299
Rio Grande Junction Ry. Co. *vs.* U. S. (T. D. 2345)..... 298
Selden *vs.* Equitable Trust Co. (94 U. S. 419)..... 205
State Line & S. R. Co. *vs.* Davis (228 Fed. 246)..... 299
Stratton's Independence (Ltd.), *vs.* Howbert (231 U. S. 399)..... 297
Traction Co. *vs.* Collectors of Int. Rev. (233 Fed. 984)..... 299
Union Hollywood Water Co. *vs.* Coster (238 Fed. 329).....89, 111
U. S. *vs.* Acorn Roofing Co. (204 Fed. 157)..... 300
U. S. *vs.* Emery-Bird-Thayer Realty Co. (237 U. S. 28)..... 297
U. S. *vs.* Guggenheim Exploration Co. (238 Fed. 231)..... 130
U. S. *vs.* Military Construction Co. (204 Fed. 153)..... 300
U. S. *vs.* Nippissing Mines Co. (206 Fed. 431)..... 299
U. S. *vs.* The Cleveland, Cincinnati, Chicago and St. Louis Ry. Co. (Feb. 23, 1916, U. S. Dist. Court, Southern Dist. of Ohio)..... 111
Waterbury Gaslight Co. *vs.* Walsh (228 Fed. 54)..... 299
Wilkes-Barre & W. V. Traction Co. *vs.* Davis (214 Fed. 511)..... 299
Zonne *vs.* Minneapolis Syndicate (220 U. S. 187)..... 295

INDEX [1]

Abatement; claim for 17
Abroad; citizen residing 14
ABSENCE; EXTENSION OF TIME BECAUSE OF:
Corporation 78
Individual 16
Absence abroad does not absolve from making return 15
Accident insurance 21
Accident; reimbursement of expenses of 21
ACCOUNT:
Advertising 209
Allowance 199
Auditing Expense 209
Auto Expense 209
Bad Debts 212
Commissions 207
Debentures 204
Depletion 211
Depreciation 211
Discounts Allowed 199
Discounts Received 199
Dividends Paid 215
Dividends Received 206
Duties 210
Fire Loss 210
Freight on Purchases 200
Freight on Sales 200, 209
Fuel, Light, Power, etc 207
General Factory Expense 209
Income from Sundry Sources 206
Insurance 209
Interest Paid 202
Interest Received 202
Inventory 201
Labor, Wages and Commissions 207
Leasehold 201
Legal Expense 209
Light, Heat and Power 207
Merchandise 215
Negative (Note) 176
Packing Supplies 209
Perpetual Inventory 217
Postage 209
Productive Wages 207

[1] Numbers refer to pages and those preceded by "L." indicate references to text of the Laws.

ACCOUNT—*Continued*
Production Supplies ... 209
Profit and Loss ... 215
Purchases ... 200
Rebates ... 199
Rents Paid ... 201
Rents Received ... 201
Repairs ... 207
Reserve for Depreciation ... 211
Return Sales ... 199
Royalties ... 202
Salaries of Officers ... 208
Sales (merchandise) ... 198
Sales of Capital Assets ... 210
Shipping Supplies ... 209
Stable Expense ... 209
Stationery and Printing ... 209
Sundry Expense ... 209
Surplus ... 215
Taxes ... 212
Telegraph and Telephone ... 209
Traveling Expense ... 209
ACCOUNT; BOOKS OF:
Best Guide to Income ... 197
Corporation's ... 196
Examination of, by Internal Revenue Officers ... 197
Individual's ... 196
Reconciliation of, with return ... 216
ACCOUNTS:
Basis of keeping; corporations and individuals ... 196, L. 228, 238
Basis of keeping; of partnerships ... 69
Distribution of ... 198
Prepayment of ... 197
Reëstablishing, of properties ... 131
What justifies charging off ... 213
Worthless (*see* "Debts, Bad.")
Accounts Receivable ... 212
Accrual basis of bookkeeping ... 196
Accruals: treatment of accruals in return ... 197
Accrued interest on bonds purchased ... 52
Accumulation of surplus ... 20, 73, L. 221
Act of 1909, Special Excise Tax on Corporations ... 305
Act of 1913, Extracts from Income Tax Law relating to Corporations ... 312
Act of 1916, Federal Corporation Capital Stock Tax Law (Sept. 8, 1916) 285
Act of 1916, Income Tax Law (Sept. 8, 1916) ... 219
Act of 1917, War Revenue Bill (Oct. 3, 1917) ... 249
Act of New York State Income Tax ... 321
Actors and Actresses; depreciation of costumes of ... 188
"Actually paid" or "paid during the year" ... 198
ADDITIONAL INCOME TAX (SURTAX):
Computation, examples of ... 7, 8, 9
Dividends included in computing ... 2
Rates of ... 2, L. 219

ADDITIONAL INCOME TAX (SURTAX)—*Continued*
Table of, under Act of 1913 320
Undistributed surplus subject to ..... 20, L. 221
ADDITIONAL WAR INCOME TAX (SURTAX):
Computation, examples of 7, 8, 9
Dividends included in computing 3
Rates of ..... 4, L. 249
ADDITIONAL INCOME AND WAR INCOME TAXES (COMBINED):
Computation, examples of 7, 8, 9, 10
Rates of 5
Table of, on various amounts of income 10
ADDITIONAL TAXES:
Computation, illustration of 7, 8, 9
Dividends included in computing 2, 3
Rates of 2, 4, 5
Undistributed profits subject to 20
Undistributed surplus of corporation subject to 73
Additions and betterments (*see* "Improvements").
Adjusting excess depreciation deductions 195
Administration of estates; income during 13, 37
Administration of Excess Profits Tax 116
Administation of Income Tax Law; provisions of 239
Administrators (*see* "Fiduciaries").
Admissions; War Tax on ..... L. 271
Advance payment of taxes 18
AGENT:
Collecting agent of foreign income 45
Foreign corporation represented by 84
Insurance agent, commissions of 39
Liability of making return 84
Power of attorney, agent under 13
Real estate agent, commissions of 57
Return may be made by 13
Agreement of sale; War Tax on ..... L. 276
Agricultural corporations, exempt 85
ALIENS, NONRESIDENT:
Income of, subject to withholding 60
ALIENS, RESIDENT:
Permanent residence 65
Temporary residence 65
Visiting 66
Alimony, not income 45
Allowance account (deductible from sales) 199
Allowance for depreciation 177
Amended returns 161, 195
Amended Income Tax Statute (Sept. 8, 1916) ..... L. 219
Amortization of bonds 177
Amortization of capital invested in munitions plant 191
Amortization of discounts on bonds 104
Annual return (*see* "Returns").
Annuities 21
Appeal, right of ..... 59, L. 244
Appendix A, Amended Federal Income Tax Law (Sept. 8, 1916) ..... L. 219

Appendix B, War Revenue Law (Oct. 3, 1917).....L. 249
Appendix C, Corporation Capital Stock Tax Law (Sept. 8, 1916) and Regulations.....L. 285
Appendix D, Special Excise Tax on Corporations (Aug. 5, 1909).....L. 305
Appendix E, Extracts from Federal Income Tax Law relating to Corporations (Oct. 3, 1913).....L. 312
Appendix F, Table of Additional Taxes imposed upon individuals by Act of Oct. 3, 1913.....L. 320
Appendix G, New York State Income Tax on Manufacturing and Mercantile Corporations.....L. 321
Apportioning income of 1916 and 1917..... 77
Appreciation in value in good will (note).....23, 187
Appreciation in value of assets not income..... 36
Assessment insurance companies, reserves of..... 114
ASSESSMENTS:
Capital Stock, assessment of, not income..... 92
Capital Stock, assessments of, not deductible by individuals..... 57
Excess profits tax, creditable.....L. 246
General assessment.....L. 230
Local benefits, assessment of..... 53
Notice of assessment, corporations..... 76
Notice of assessment, individuals..... 17
Recovery of..... 79
Second assessment..... 79
ASSETS:
Computing profit on sales of.....33, 34, 35
Deferred..... 197
Income on sales of..... 33
Treatment of depreciation in sales of..... 34
Associations; income of mutual..... 91
Attorney's fees; when returnable..... 33
Auto trucks, depreciation of..... 186
Automobiles, War Tax on.....L. 268
Auxiliaries, depreciation of..... 184

Bad debts..... 213
BANKS:
Depreciation of securities..... 187
Doing business as partnership..... 14
Gross profit of..... 91
Interest on deposits in..... 45
Returns by private banks..... 14
Taxes on stock of..... 58
Banking department; order by State or Federal..... 187
Bankruptcy of debtor..... 213
Batteries; depreciation of storage..... 184
BENEFICIARIES:
Heirs and legatees, income of.....37, L. 220
Income received by..... 37
Proceeds of accident policy..... 21
Proceeds of life insurance..... 21
Return by.....13, 37
Undistributed income returnable by fiduciary..... 37

Bequests and gifts, exempt 37
Betterments (*see* "Improvements").
Beverages, War Tax on ..... L. 258
Board and lodging in lieu of cash 32
Boards of trade, exempt 84
Boilers and engines, depreciation of 182
Bonded indebtedness 173, 215
BONDS:
Accrued interest on bonds purchased 52
Amortization of bonds 177
Charging off depreciation of bonds 187
Debenture bonds, interest on 204
Discounts on 104
Discounts on, charged off prior to 1909 106
Exchange of, in reorganization 93
Income on Government bonds 40, 41
Interest on bonds 104
Liberty Loan 41
Premium on fidelity bond paid by employee 53
Premium on bonds purchased 105
Redemption of bonds 105
Tax-free covenants in bonds ..... 62, L. 229
Withholding tax from interest on bonds 62
BONUSES:
Taxable as income of recipient 110
When deductible 108
BOOK VALUE:
Decrease in book value not deductible 187
Increase in book value not income 187
BOOKKEEPING METHODS:
Corporations' 196
Cost-system 216
Individuals' 196
Bookkeeping suggestions 196
Books of Account (*see* "Accounts, books of").
BRANCHES, FOREIGN:
Corporations having 84
Rates of exchange of 44
BRANDS:
Depreciation of 188
Loss on sale of 188
Brokers; special return by (names of customers, etc.) ..... L. 245
BUILDINGS:
Buildings erected by tenant 180
Depreciation on buildings, generally 178
Depreciation on dwellings 180
Depreciation on factory buildings 179
Depreciation on farm buildings 178, 181
Determining cost of buildings for depreciation purposes 179
Dilapidated buildings removed by authority of Government 57
Improvements and betterments 56, 180
Repairs to buildings 179
Voluntary removal of building 56

BUSINESS:
Doing business; what constitutes 295
Individuals having more than one business 54
Losses in business 54
Place of business, filing returns at 15

Cabaret, War Tax on 271
Cables and wires, depreciation of 184
CALENDAR YEAR:
Corporation return for ..... 76, L. 230
Individual tax based on ..... 11, L. 226
Cameras, War Tax on ..... L. 269
Campaign expenses 57, 113
CAPITAL ASSETS:
Appreciation in value of 187
Depreciation of 175
Increase or decrease in book value of 160
Losses on 34, 210
Profits on 33, 35, 91, 210
Sales of 33, 210
Treatment of depreciation in sales of 34
Valuation of 35
CAPITAL EMPLOYED IN THE BUSINESS:
Definition of 203
Interest deductible based on 203
CAPITAL, INVESTED (EXCESS PROFITS TAX):
Accounts payable, deduction from 157, 163
Accounts receivable 155, 159
Accruals as 157, 163
Bills Payable 157, 163
Bills Receivable 155, 160
Bonds, discussion of 173
Bonds payable 157, 163
Books of account, showing 130
Books of account, relation of 130
Buildings as 156, 162
Cash as 155, 159
Copyrights 129
Definition of 128
Depreciation charged off prior to incidence of Excise Tax 161
Depreciation charged off in excess 161
Determined, how 134
Dividends declared 157, 164
Druggists, capital of 133
Examples of computing 155–165
Foreign businesses 129
Franchise 138
Furniture and fixtures 156, 162
Good will 138, 157, 163
Good will, trade-marks and franchises 138
Good will written off 131
Individuals, capital of 129, 154
Inventory valuations 167

CAPITAL, INVESTED (EXCESS PROFITS TAX)—*Continued*
Investments as....155, 160
Land....156, 162
Liberty Loan bonds....130
Nominal capital....133
Organization expenses....166
Ownership, partial change of....135
Partnerships....128
Patents....129
Patterns and designs....167
Plant and machinery....155, 160
Plates and dies....167
Prepayments....157, 163
Professions....133
Property accounts, depreciated....132
Property accounts, reëstablishing in books of account....131
Property, actual value of, discussion....174
Reorganization after Jan. 2, 1913....136
Reserve accounts and funds....138
Reserve for amortization of bonds....140
Reserve for bad debts....140
Reserve for loss on investments....140
Reserve for working capital....140
Reserve for depreciation and depletion....140
Reserves, generally....157, 164
Revaluation of property....153
Securities, inventory of, by dealer....167
Stocks and bonds....128
Stock on hand....155, 160
Subscriptions to capital stock....166
Surplus....154, 158, 164
Tangible property, value of....129
Trade-marks....138
Treasury stock....166
Undistributed surplus of taxable year....128
Capital returned to stockholders....31
CAPITAL STOCK:
Assessment of capital stock not income....92
Capital stock outstanding at close of year....212
Depreciation of stock....187
Dividends on stock (*see* "Dividends").
Estimating value of....302
Exchange of property for stock....93
Exchange of shares....27, 93
Preferred, interest on....104
Sale of rights to subscribe to....30
Sale of stock at premium....94
Stock having no par value....203
War Tax on certificates of....L. 275
Capital Stock Tax Law (Sept. 8, 1916)....L. 285
Capital Stock Tax Law Regulations....286
Carrying charges of real estate company....96
Cemetery companies, exempt....85

Certificates of indebtedness of U. S. accepted in payment of taxes. . . 19
Certificates of stock; war tax on . . . 275
Charitable organizations, exempt . . . 85
Charities, contributions to . . . 52, L. 223
Christmas gifts to clergymen . . . 33
Cigars and tobacco, War Tax on . . . L. 264
Citizen residing abroad must make return . . . 15
Civic league or association, exempt . . . 85
CLAIMS:
Abatement of assessment . . . 17
Excess amounts paid to Government . . . 17
Refund of taxes . . . 17, 18
Specific exemptions . . . 51
Statute of limitation . . . 59
Clergymen; income of . . . 33
"CLOSE CORPORATIONS":
Dividends credited by . . . 21
Not exempt . . . 87
Clubs organized for pleasure and recreation, exempt . . . 85
Collateral; interest on debts secured by . . . 204
Collecting agents of foreign income . . . 45, L. 229
COLLECTION OF TAX; DUE DATE AND PENALTY FOR DELAYED PAYMENTS:
Corporations . . . 76
Individuals . . . 17
COLLECTORS OF INTERNAL REVENUE:
Duties of . . . L. 241
Returns made by collectors for corporations . . . 79
Returns made by collectors for individuals . . . 17
Commission account . . . 207
COMMISSIONS:
Insurance agents' . . . 39
Labor, wages and commissions . . . 207
Real estate agents' . . . 57
Salesmen's . . . 33
Trustee's . . . 33
When returnable . . . 33
Compensation of trustee . . . 33
Compromise of penalty for failure to make return . . . 16
Conservators (*see* "Fiduciaries").
Contingent reserves . . . 103, 138
Contracting corporations; gross income of . . . 90
Contractor doing work for State . . . 40
Contributions (bonus) . . . 108
Contributions to charities . . . 52, L. 223
Contributions to campaign expenses . . . 113
Conveyances, War Tax on . . . 277
Co-operative associations (exempt) . . . 85
Co-partnerships (*see* "Partnerships").
Copyright; depreciation of . . . 186
CORPORATE OBLIGATIONS:
Exempt organizations subject to withholding of tax . . . 86
Interest on bonds, mortgages, and deeds of trust . . . 63
Limitation of interest deductible . . . 202

CORPORATE OBLIGATIONS—*Continued*
Tax-free covenant 62
Corporation Capital Stock Tax Law ..... L. 285
Corporation Capital Stock Tax Regulations ..... L. 286
CORPORATIONS:
Additions and betterments 180
Agent of foreign 84
Apportionment of income for 1917 77
Assessment of capital stock of 92
Bonds issued at discount 104
Books of account 196
Close corporations 87
Cost-system 216
Deductions (*see* "Deductions in returns of corporations").
Dividends (*see* "Dividends").
Doubtful as to exemption 87
Exempt organizations 84
Exempt organizations includes foreign, of the same classes 87
Fiscal year of ..... 77, L. 237
Foreign income of domestic corporations 73
Foreign branches 44, 80
Gross income from all sources 90
Gross income of banks 91
Gross income of contracting corporations 90
Gross income of insurance companies 91
Gross income of manufacturing corporations 90
Gross income of mercantile corporations 90
Gross income of miscellaneous corporations 90
In liquidation 82
Income of domestic corporations ..... 72, 89, L. 230
Income of foreign corporations ..... 72, L. 230
Incompletely organized corporations 80
Interstate commerce 83
Losses of, when deductible 101
Net income 72
Organized during the year 81
Return, false or fraudulent 78
Return, foreign corporations 76
Return, holding companies 80
Return, mercantile corporations 75, 76
Return prepared by Collector of Internal Revenue 79
Return, refusal or neglect to prepare 79
Return, receivers and trustees 81
Return, specific exemption 73
Return, subsidiary companies 81
Return, when due, where, etc ..... 76, L. 237, 238
Return, withheld taxes 63
Water companies 89
Year, tax ..... L. 237
CORPORATIONS, FOREIGN:
Agent of 84
Deductions allowed 114
Dividends of 31

CORPORATIONS, FOREIGN—*Continued*
Income of....72, L. 235
Where to file return.... 76
CORPORATIONS; NONRESIDENT FOREIGN:
Withholding tax on income of.... 61
COST SYSTEM:
Manufacturing corporation operating.... 216
"Purchases" according to.... 200
Reliability of.... 200
Cost of manufactures....216, 217
COST OF PROPERTY ACQUIRED PRIOR TO MARCH 1, 1913:
Corporations.... 91
Individuals.... 35
Cost of property acquired since March 1, 1913.... 36
Cost of real estate.... 36
Costumes of actors; depreciation of.... 188
Courts; jurisdiction of....L. 244
Crop shares; farmers'.... 49
Custom House entries; War Tax on....L. 277
Customs duties.... 59

Damages received for injuries sustained.... 21
Damage suits, test of deductibility of payment of.... 57
Debenture bonds; interest on.... 204
DEBTS, BAD:
Bankruptcy.... 213
Corporations.... 102
Deductible.... 213
Individual.... 55
Reserve for.... 102
Deceased persons; income to time of death of.... 13
DEDUCTIONS IN RETURNS OF DOMESTIC CORPORATIONS:
Allowable....100, L. 233
Amortization of bonds.... 177
Bad debts.... 102
Bonuses.... 108
Campaign expenses.... 113
Defalcation, embezzlement.... 111
Depletion....101, L. 233
Depreciation....101, L. 233
Expenses, necessary....100, L. 233
Improvements (not deductible)....110, L. 234
Interest....103, L. 234
Lobbying expense.... 111
Losses....101, L. 233
Maintenance expenses.... 102
Organization expenses.... 111
Premium on bonds.... 105
Salaries of National Guardsmen.... 110
Salesmen's expenses.... 110
Taxes....110, 212, L. 235
DEDUCTIONS IN RETURNS OF FOREIGN CORPORATIONS:
Depletion....114, L. 236

DEDUCTIONS IN RETURNS OF FOREIGN CORPORATIONS—*Continued*
Depreciation....114, L. 235
Improvements (not allowed)....115, L. 236
Interest....115, L. 236
Losses....114, L. 235
Necessary expenses....114, L. 235
Restoring property.... 115
Taxes....115, L. 237
DEDUCTIONS IN RETURNS OF INDIVIDUALS:
Accrual basis of bookkeeping.... 196
Bad debts....55, L. 223
Contributions to charities....52, L. 223
Depletion....56, L. 223
Depreciation....55, L. 223
Dividends....2, 3
Exemptions (*see* "Exemptions").
Improvements (not deductible)....56, L. 223
Interest....52, L. 222
Living expenses (not deductible).... 52
Losses....54, L. 222
Necessary expenses....52, L. 222
Nonresident alien, deductions of....L. 224, 225
Normal tax withheld.... 52
Only items applicable to the year deductible.... 33
Prorating compensation of trustees.... 33
Taxes....53, L. 222
Taxes on bank stock.... 58
DEDUCTIONS UNDER EXCESS PROFITS TAX:
Allowable.... 141
Applicable to real and nominal capital.... 152
Foreign nonresident businesses.... 146
Interest on capital.... 172
Interest on loans by partners.... 171
Representative concerns....134, 147
Salaries of partners and individuals.... 169
Salary allowance, partnerships.... 148
Wages, members of farmer's family.... 151
Defalcation when deductible.... 111
Deferred assets.... 197
Delay in filing return (*see* "Failure to file return").
DELAYED PAYMENT OF TAX; PENALTY:
Corporation.... 76
Individual.... 17
DEPLETION OF NATURAL DEPOSITS:
Deductible by corporations.... 181
Deductible by individuals.... 56
Deductible by nonresident aliens.... 225
Gas and oil wells.... 181
Ledger account of depletion.... 211
Limitation of depletion.... 223
Mines.... 181
Purpose of depletion.... 211

DEPRECIATION:
Account of depreciation ... 211
Adjusting excess ... 195
Deductible by corporation ... 100
Deductible by individual ... 55
Definition of ... 175
Diminishing value method ... 175
Entries of depreciation ... 211
Equal instalment method ... 175
Excess charge for depreciation ... 161, 195
Fixing upon rates of depreciation ... 178
Limitation of amount chargeable ... 178
Methods of computing ... 175
Rates of, indicated by Department (notes) ... 178, 182, 186
Rates of depreciation, generally ... 178
Repairs and replacements ... 183
Reserve for depreciation ... 176
Treatment of depreciation in sales of capital assets ... 34
Property subject to depreciation:
Auto trucks ... 186
Auxiliaries ... 184
Belted generators ... 184
Boilers ... 182
Boot trade ... 193
Brands (not deductible) ... 188
Breweries ... 193
Buildings ... 178
Collieries ... 193
Copyrights ... 186
Dwellings ... 180
Dyers and trimmers ... 193
Engines ... 182
Farm buildings ... 178, 181
Furniture and fixtures ... 180
Goodwill (not deductible) ... 187
Horses ... 186
Hosiery trade ... 193
Inventories ... 167, 188
Investments (not deductible) ... 187
Lace makers ... 193
Laundry equipment ... 184
Leased property ... 180
Looms ... 193
Machinery ... 182
Miscellaneous equipment ... 184
Motors ... 184
Munitions works ... 190
Newspapers and printing ... 193
Patents ... 185
Patterns ... 185
Rolling stock ... 194
Securities ... 167, 187
Sewing machines ... 193

DEPRECIATION—*Continued*
Shafting ... 184
Ships ... 192
Shipyards ... 194
Shop equipment ... 184
Spinning machinery ... 194
Stable equipment ... 186
Steam piping ... 184
Steam turbines ... 184
Stock on hand ... 167, 188
Stocks and bonds ... 187
Storage batteries ... 184
Switchboards ... 184
Theatre costumes ... 188
Timber land ... 182
Tools ... 184
Trade-marks (not deductible) ... 188
Tramways ... 194
War materials ... 190
Weaving trade ... 194
Wires and cables ... 184
Disclosing information prohibited ... L. 241
Discounts allowed ... 199
Discounts received ... 199
Discount on bonds charged off prior to Jan. 1, 1909 ... 106
DISCOUNTS; RESERVE FOR:
Amortization of discounts on bonds ... 104
Discounts on sales of merchandise ... 103
DISSOLVED CORPORATION:
Liability for tax of ... 82
Return of capital of ... 31
Distribution of accounts ... 198
District Court, jurisdiction of ... L. 244
Diverting reserves ... 177
DIVIDENDS:
Accounts of ... 206, 215
Creditable as to normal tax ... 51, L. 223
Credits to partners for proportionate share of ... 70
Declared out of profits earned prior to March 1, 1913 ... 22
Declared out of capitalized good will (note) ... 23
Declared payable in securities ... 23, 91
Definition of ... 21, L. 247
Distributed or undistributed ... 21
Double tax on ... 75
How taxable ... 21, 22, 23, L. 247
Life Insurance policies ... 20
Must be included in return ... L. 228
Not subject to normal tax ... 2, 3
Received by corporations ... 75
Received by individuals ... 21, 22, 23
Received by nonresident foreign corporations ... 61
Received by nonresident alien individuals ... 60
Received by partnerships ... 69

DIVIDENDS—*Continued*
Received from foreign corporations 31
Reserves, dividends paid out of 24, 25, 26
Returns of, by corporations (names of stockholders) ..... L. 245
Stock dividend 23
Stock dividend to nonresident foreign corporation 67
Subject to additional taxes ..... 22, L. 220
Doctors, fees of 33
Donations (*see* "Gifts").
Drafts, Time, War Tax on ..... L. 277
DUE DATE:
Payment of tax by corporations 76
Payment of tax by individuals 17
Return of corporations 76
Return of individuals 15
Return, when last day falls on Sunday or legal holiday 76
Dues, War Tax on ..... L. 271
Duress, payment under 59
Duty, customs 59
Duties account 210
Dwellings, depreciation of 180

Embezzlement, deduction of 111
Engines and boilers, depreciation of 182
Entertainment by salesmen, when deductible 110
Estate Tax, War ..... L. 278
ESTATES:
Exemption of 51
Income of ..... 37, L. 220
Sale of securities by 35
EXCESS PROFITS TAX:
Administration of 116, 152
Assessment deductible from income tax ..... 8, 10, L. 246
Capital invested (*see* "Capital, invested").
Deductions allowed (*see* "Deductions").
Duration of 118
Examples of computing 142
Exempt organizations 117
Incidence of 118
Income exempt from 117
Invested capital (*see* "Capital, invested").
Investments, income from, not subject to 126
Landowner, when subject to 123
Method of computing, where capital is employed .. 142, 143, 144, 145
Method of computing, where no capital employed 8, 145
Mines, oil wells and timber lands, income from 124
Occupation and salary, defined 123
Old tax repealed 118
Partners' profits not subject to 171
Partnership, assessment of, should be apportioned to partners 121
Partnership, domestic, returns of 120
Partnership, foreign, returns of 121
Penalties, failure to make return and for false return 121

EXCESS PROFITS TAX—*Continued*
Prewar years (*see* "Prewar period").
Principle of computing ... 118
Rate of, where no capital is employed ... 119
Rates of, where capital is employed ... 118
Real or nominal capital ... 152
Return, due date of filing ... 121
Returns, nonresident aliens and foreign corporations ... 120
Taxable year, defined ... 119
Undistributed surplus of taxable year ... 128
Who is subject to tax ... 117
Excess Profits Tax Law (Text of) ... L. 251
Exchange, rates of foreign ... 44
Exchange of stock and bonds in reorganization ... 93
Excise Tax on Corporations (Act of 1909) ... L. 305
Executors, returns by ... 13
EXEMPT CORPORATIONS AND ORGANIZATIONS:
Classes of ... 84
Doubtful as to exemption ... 87
Foreign ... 87
Must withhold at source ... 86
Salary received from ... 32
Water companies, not exempt ... 89
Exempt income of individuals ... L. 221, 222
Exempt, tax, clause in bonds ... 62
EXEMPTIONS, SPECIFIC:
Claims for ... 51
Corporation (under Income Tax Law) ... 73
Corporation (under Excess Profits Tax Law) ... 141
Estate ... 51
Individual, under Income Tax ... 2, 51
Individual, under War Income Tax ... 3, 51
Individual, under Excess Profits Tax ... 141
Individual, nonresident alien ... 2, 51
Prorating exemption between husband and wife ... 12
Ward, *cestui que trust* ... 51
Expense accounts, sundry ... 209
Expenses, necessary to business ... 52, 100
Expenses on account nontaxable income ... 57
EXTENSION OF TIME:
Corporation ... 78
Individual ... 16

FAILURE TO FILE RETURN, PENALTIES FOR:
Compromises of ... 16
Corporations' ... 78
Individuals' ... 16
FAILURE TO PAY TAX, PENALTIES FOR:
Corporations' ... 76
Individuals' ... 17
FALSE RETURNS, PENALTIES FOR:
Corporations' ... 78
Individuals' ... 17

Family, head of, defined (note) 2
Family, head of, exemptions 51
FARM AND FARMER:
Books of account of 50
Buildings 178, 181
Deductions allowed farmer 48
Definition of 48
Depreciation of farm property 50
Expenses of 49
Income of 49
Losses of 49
Maintained for recreation only 50
Shares in 49
Stock of 49, 50
Federal Corporation Capital Stock Tax Law and Rulings ..... L. 285
Federal Farm Loan, interest on, exempt 40
Federal Income Tax Law (Sept. 8, 1916) ..... L. 219
Federal Trade Commission 175
Fees, professional; when returnable 33
Fidelity bond, premium on 53
FIDUCIARIES:
Agents are not fiduciaries 13
Compensation of 33
Income from 37
Indemnity to ..... L. 221
More than one fiduciary 13
Receivers 81
Return by ..... 12, L. 227
FILING RETURN:
Due date of 16
Where to file 15
Final returns (*see* "Tentative returns").
Fire insurance premiums 57
Fire loss, treatment of account of 210
FISCAL YEAR OF CORPORATION:
Extension of time 78
How to adopt fiscal year 77
When return is due under fiscal year 77
When tax payable 78
Fiscal year of partnerships ..... 68, L. 227
Floor tax ..... L. 270
Foreign corporations (*see* "Corporation, Foreign").
Foreign exchange, rates of 44
FOREIGN INCOME:
License required by collectors of ..... 45, L. 229
Of nonresident aliens 46
Foreigners (*see* "Aliens").
Forms must be obtained by taxpayer 12
Fraud, unreasonable accumulation of surplus evidence of ..... 20, L. 221
Freight on purchases 200
Freight on sales 200, 209
Fuel, light and power 207
Funds and Reserves 138

"Fundamentals of a cost-system for manufactures" 175
Furniture and fixtures 180

GAS WELLS:
Depletion of 56, 181
Royalties 181
Generators, depreciation of belted generators 184
GIFTS:
Bonuses 108
Christmas gifts 109
Exemption of ..... 37, L. 222
Gratuities, test of deductibility 108
Income from gifts 37
Received by clergymen 33
GOOD WILL:
Depreciation of 187
Dividend declared out of capitalized (note) 23
Invested capital 131, 138, 157, 163
Treatment of account 187
Government, foreign, income of ..... L. 246
GOVERNMENT BONDS, INCOME FROM:
Liberty Bonds, 3½ per cent 41
Liberty Bonds, 4 per cent 41
Miscellaneous 40
Government employees, income and expenses of 41
Gratuities (*see* "Gifts").
GROSS INCOME:
All sources 90
Banks 91
Contracting corporations 90
Insurance companies 91
Manufacturing corporations 90
Mercantile corporations 90
Miscellaneous corporations 90
GUARDIANS:
Deduction of exemption of ward or *cestui que trust* 51
Return by ..... 12, L. 227
Gum, chewing, War Tax on ..... L. 269

HEAD OF FAMILY:
Definition of ..... (note) 2
Exemptions of 51
Heat, light and power account 207
Heirs and legatees, income returnable 37
Holding companies, returns of 80
Holiday, when due date falls on 76
Horses, depreciation of 186
Horticultural organizations 85
Household expenses; not deductible 52
How to adopt fiscal year of corporation 77
HUSBAND AND WIFE:
Exemption of, may be prorated 12
Returns by 12

HUSBAND AND WIFE—*Continued*
Separate income, computing additional tax 12
Specific exemption 51

Impairment of capital account 215
IMPROVEMENTS:
Betterments 56
Leased property 180
Local benefits 53
Not deductible 56
Repairs 179
In trade, defined 54, 55
INCOME:
Accrued 197
Apportionment of income for 1916 and 1917 in case of designated fiscal year 77
Appreciation in value, not income 36
Attorneys' fees 33
Beneficiaries 37
Bonuses 32, 108, 110
Clergymen 33
Commissions of insurance agents 39
Corporations, domestic ..... 72, 88, L. 230
Corporations, foreign ..... 72, L. 235
Deduction from (*see* "Deductions").
Estates 37
Exempt from tax ..... L. 221, L. 233
Government employees 41
Gross income (*see* "Gross Income").
Heirs and legatees 37
In trade 55
Individuals 19
Instalment business 98
Interest (*see* "Interest").
Legacies 37
Money equivalent 32
Oil wells, mines, and timber lands 124
Partnerships, general 69
Partnerships, limited 70
Professional services 33
Promissory note 36
Public utility ..... L. 233
Real estate development corporation 94, 95
Rents, when returnable 39
Return (*see* "Returns").
Salaries, when returnable 31
Sale of stock rights 30
Sinking fund, interest on 92
Stock received in reorganization 29
Subject to withholding 60
Sundry sources 206
Table of rates on various amounts of (individuals) 10
Timber, lumber and stumpage 99

INCOME—*Continued*
Undivided surplus of corporations ... 20
Income taxes applicable to income of year 1917 ... 1
Income taxes paid not deductible ... 53
Incorporation expenses ... 111
Indebtedness, bonded, interest paid on ... 173, 215
Indebtedness, interest bearing ... 215
Indemnity to withholding party ... 63
INDIVIDUALS:
Deductions of ... 51
Income of ... 19
Income of nonresident aliens ... 60
Returns of ... 11
Information at source ... 63, L. 246
Inheritance tax, not deductible ... 58
Injuries, damages received on account of ... 21
Instalment business ... 94, 98
Instalment payment of taxes ... 18
INSURANCE:
Accident ... 21
Account of ... 209
Agents ... 39
Annuities ... 21
Damages ... 21
Dividends ... 20
Injuries ... 21
Losses not compensated for by ... 57
Partnership and corporation ... 69, 107, L. 247
Premiums, fire ... 57
Premiums, life ... 58
Proceeds of policy of ... 21, L. 221
Reserves for ... 57
Settlement under state compensation laws ... (note) 21
War tax on ... L. 267
INSURANCE COMPANIES:
Additions to reserve funds ... 113
Assessment companies ... 114
Gross income of ... 91
Losses by ... 113
Mutual ... 91
Reserves of ... 114
Returns of ... 75
Interstate Commerce corporation, return of ... 83
INTEREST:
Account ... 202
Accrued on bonds bought ... 52
Annuities ... 21
Bank deposits ... 45
Bonds, information at source ... 65, L. 246
Collateral subject to sale, etc ... 104
Cost of manufactures ... 200
Debenture bonds ... 204
Deductible by corporations ... 103, 104

INTEREST—*Continued*
Deductible by individuals 52
Government bonds 40, 41
Incurred in purchase of Liberty Loan Bonds, 4% 52, 103
Liberty bonds, 3½% 41
Liberty bonds, 4% 41, 103
Limitation of corporations 202
Obligations of State ..... L. 222
Preferred Stock 104
Sinking funds 92
Tax-free covenant 62
Withholding at source on 62, 63
INTERNAL REVENUE OFFICERS:
Examination of books by 197
When returns may be prepared by 17
INVENTORIES (STOCK ON HAND):
Account 201
Depreciation of 188
Equivalent of 217
Valuations of 167
Invested capital (*see* "Capital, invested").
Investments, depreciation of 56
Investments, foreign, rates of exchange on 44

Jewelry, War Tax on ..... L. 269
Joint fiduciaries 12
Journal entries of depreciation 211
Joint-stock companies (*see* "Corporation").
Judgments, test of deductibility of 57
Jurisdiction of District Court ..... L. 244

Labor, wages and commissions 207
Land, not subject to depreciation 179
Land, timber 182
Last day, when last day to file returns falls on Sunday or legal holiday .. 76
Laundry equipment, depreciation of 184
Lawyer's fees, when returnable 33
LEASED PROPERTY:
Additions to 180
Permanent buildings erected by tenant 180
Leasehold account 201
Legacies, not income 37
Legatees, income of, returnable 37
Liberty Loans, interest on 41, 103
License required by collecting agents 45
Life insurance (*see* "Insurance").
Limitations, statute of (*see* "Statute of Limitations").
LIMITED PARTNERSHIPS:
How created 70
Profits of 31
Returns of 70
Liquidation, corporation in 31
Liquors, War Tax on ..... L. 258

Living expenses, not deductible 52
Living quarters part of compensation 32
Local benefits, not deductible 53
Lodging, board and, in lieu of money 32
LOSSES:
Bad debts (*see* "Debts, bad").
Deductible by domestic corporation 101
Deductible by foreign corporation 114
Deductible by individual 54
Deductible by nonresident alien ..... L. 224
Definition of 54
Farms and farmers 49
Fluctuating 56
In trade 54, 55
Retirement of bonds 106
Speculations, losses in 55
When deductible 101
Lumber, and stumpage, profit or loss on 99

Machinery, depreciation of 182
Mailing returns in due time 76
Maintenance expenses 102
MANUFACTURING CORPORATION:
Cost-system of 216
Gross income of 90
Market value of securities, how determined 35
MARRIED PERSON:
Exemption of 51
Status of, when determined 51
"Massachusetts Trusts" 294, 299
Medicines, War Tax on ..... L. 269
MERCANTILE CORPORATION:
Gross income of 90
MERCHANDISE:
Account 215
Allowances 199
Purchases of 200
Sales of 198
METHOD OF BOOKKEEPING:
Corporations 196
Cost-system 216
Individuals 196
METHOD OF COMPUTING TAX:
Excess profits 142, 143, 144, 145
Normal and additional 6, 7, 8, 9
Military service, verification of returns of persons in 15
Mines, depletion of 56
Mines, oil wells, and timber lands, income from 124
Miscellaneous corporations, gross income of 90
Misrepresentation by omission or declaration 196
Money equivalent, income received in 32
Motors, depreciation of 184
Municipalities, interest on obligations of 39

Munitions Tax creditable (Capital Stock Tax).....L. 286
Mutual insurance companies, income of.....91, L. 236

National guardsmen, salaries of..... 110
Nationality of husband, wife assumes..... 66
Naval service, verification of returns of persons in..... 15
Negative account.....(note) 176
NET INCOME DEFINED:
Corporations..... 89
Individuals.....19, L. 220
New York State Income Tax Law.....L. 321
Nonresident citizen required to make return..... 15
NONRESIDENT ALIEN:
Deductions of.....L. 224, 225
Exemption (None)..... 51
Foreign income of..... 46
Income of.....L. 219
Return, where filed..... 15
Stock of, held by another..... 46
Withholding from income of.....60, L. 228
NONTAXABLE INCOME:
Corporations.....L. 233
Individuals.....L. 221
NORMAL TAX:
Dividends not subject to.....51, L. 223
Examples of computing..... 6
Income Tax.....2, L. 219
Limited partnerships, distributed income of, not subject to..... 31
War Income Tax.....3, L. 249
NOTES, PROMISSORY:
Equivalent to cash receipts..... 36
War Tax on.....L. 277
NOTICE OF ASSESSMENT BY COLLECTOR:
Corporation..... 76
Individual..... 17
NOTICE TO COLLECTOR:
Corporation designating fiscal year..... 77
Extension of time..... 78

Obligations of Government, interest on..... 40
Obsolescence as element of loss.....(note) 175
Office equipment..... 180
Officers' salaries..... 208
OIL WELLS:
Depreciation of..... 56
Income of..... 124
Ores, depletion of (*see* "Mines").
Organization expense, not deductible..... 111
Organizations exempt..... 84

Paid: "actually paid" or "paid during the year"..... 198
Parcel post packages, War Tax on.....L. 278
PARTNERS:
Creditable with share of excess Profits Tax assessment..... 121

PARTNERS—*Continued*
Credits on individual returns of ... 70
Drawing accounts of ... 148
Life insurance of ... 69, 107
Returns of ... 68
Salaries of ... 169
Subject to income taxes only ... 68
PARTNERSHIPS:
Dividends received by ... 69
Exclusion of interest on Government obligations in returns of ... 70, L. 227
Expenses of ... 70
Fiscal year of ... 68, L. 227
Income of ... 69
Income Tax, Returns of ... 68, L. 227
Limited partnership, taxable as corporation ... 70
Not required to make income tax return unless order ... 68, L. 227
Foreign, not subject to withholding ... 61
Profits, distributed or not ... 69, L. 227
Profits, when accrued ... 69
PARTNERSHIPS, LIMITED:
How created ... 70
Make returns as corporations ... 70
Profits of ... 31, 71
PATENTS:
Depreciation of ... 185
Royalties from ... 202
Patterns, depreciation of ... 185
PAYMENT OF TAXES:
By instalments ... 18
Certificates of indebtedness of the U. S ... 19
Uncertified cheques ... 19
When due ... 17, 76
PENALTIES FOR DELAYED PAYMENT OF TAX:
Corporations ... 76, L. 239
Individuals ... 17, L. 228
PENALTIES FOR FAILURE TO FILE RETURN:
Corporations ... 78, L. 243
Individuals ... 16, L. 243
PENALTIES, SUNDRY:
False or fraudulent return ... 78, L. 240
Refusal or neglect to make return ... 79, L. 240
PENSIONS:
Paid to retired employees ... 53, 110
Received from United States ... 45
Perfumes and toilet articles, War Tax on ... L. 269
Permanent improvements (*see* "Improvements").
Personal exemptions ... 51
Philippine Islands, taxes not applicable to ... 19
Pianos, War Tax on ... L. 268
Piping, steam, depreciation of ... 184
PLACE OF BUSINESS, FILING RETURNS AT:
Domestic corporations ... 76
Foreign corporations ... 76

PLACE OF BUSINESS, FILING RETURNS AT—*Continued*
Individuals ... 15
Nonresident aliens ... 15
Subsidiary companies ... 81
Playing cards, War Tax on ... L. 278
Political campaign expenses ... 57, 113
Political subdivision, defined ... 40
Porto Rico, taxes not applicable to ... 19
Postal Rates, War Tax on ... L. 281
Power, fuel, light, etc ... 207
Power of attorney, agent acting under ... 13
Power of attorney, War Tax on ... L. 277
Preferred stock, interest on, not deductible ... 104
PREMIUMS:
Bonds purchased ... 105
Bonds redeemed ... 105
Fidelity bond, paid by employee ... 53
Fire insurance ... 57
Life insurance, individuals ... 58
Life insurance in favor of partnership or corporation ... 69, 107, L. 247
Prepayments, treatment of, in returns ... 197
PRESIDENT OF UNITED STATES:
Inspection of return subject to order of ... 79
Salary of, exempt ... 51
PREWAR PERIOD (EXCESS PROFITS TAX):
Business not in existence during ... 146
Definition of ... 120
Returns for, corporations ... 121
Returns for, individuals ... 123
Returns for, limited partnerships ... 122
Returns for, partnerships ... 123
Returns for, when required ... 121
Returns for, when not required ... 172
Subnormal profit in ... 146
Price: Fair market price or value ... 35
Professional fees, when returnable ... 33
Profit and Loss account ... 215
PROFIT:
Accumulation of profit of corporation ... 73
Definition of ... 36
In trade ... 55
Sales of capital assets ... 33, 34, 35
Profit returnable by legatee ... 37
Promissory note, income ... 36
Property acquired by gift ... 37
PROPERTY ACQUIRED PRIOR TO MARCH 1, 1913:
Computing profit or loss on ... 33, 34, 35, L. 221, 231
Property: Restoring property ... 56
PRORATING:
Cost of improvements by tenant ... 180
Exemption, husband and wife ... 12
Loss on sale of bonds ... 104
Profit or loss on sale of capital assets ... 34, 210

Protest to assessment and collection..... 59
Proxies, War Tax on.....L. 277
Public records, returns become.....79, L. 240
Public utilities, War Tax on.....L. 265
Public utility, payments to Government by..... 111
PURCHASES:
Account of..... 200
Discounts received on..... 199
Merchandise..... 215
Freight on..... 200

Railroad company, damages received from..... 21
Ranches (*see* "Farms").
RATES OF INCOME TAXES:
Corporations.....72, L. 230
Individuals.....2, 3, 4, 5
Table of, on various amounts..... 10
RATES OF EXCESS PROFITS TAX:
Capital..... 118
Nominal capital..... 119
Rates, water..... 53
Rates of depreciation..... 178
Real estate, sales of.....36, 94, 96
REAL ESTATE AGENTS:
Commissions paid to..... 57
REAL ESTATE COMPANIES:
Accounts of..... 94
Development corporations..... 94
Property collateral of..... 104
Rebates..... 199
Receipts for taxes paid.....17, L. 243
Receivers (*see* "Fiduciaries").
Record owner of stock not actual owner..... 46
Redemption of bonds..... 105
Refund, claims for..... 17
Refusal to file (*see* "Penalties").
Regulations, Corporation Capital Stock Tax Law.....L. 286
Renewals and improvements..... 102
Renewals of office equipment..... 180
RENT:
Account of.....39, 201
Crop shares received by farmer..... 48
Interest paid in lieu of..... 202
Real estate agent collecting..... 57
When returnable..... 39
Rental value as income..... 32
Rents: Paid and received..... 201
REORGANIZATION:
Exchange of stock and bonds in..... 93
Stock received in..... 29
REPAIRS:
Buildings..... 179
Incidental..... 183

REPAIRS—*Continued*
When deductible ... 183
Replaced buildings ... 56
Replacements, test of deductibility ... 183
RESERVES:
Bad debts ... 102
Contingent ... 103
Depreciation ... 176
Discounts on sales ... 103
Diverting reserves ... 177
Dividends paid out of ... 24
Insurance ... 57
Insurance companies ... 103
Miscellaneous, as invested capital ... 140, 157, 164
Secret ... 103
Separate accounts of ... 177
Sinking fund ... 103
RESIDENCE:
Citizen residing abroad ... 15
Definition of ... 65, 66
Depreciation of dwelling ... 180
Resident alien ... 65
Temporary, in the U. S. ... 65
Retirement of bonds, loss in ... 105
Restoring property, not deductible ... 56
RETURN:
By agent ... 13, L. 226
Defined ... 11
Publicity of ... 79
Receivers and trustees must make ... L. 238
Reconciliation of, with books of account ... 216
Taxes, withheld ... 63
Tentative and amended ... 80
Verification of, by inspectors of Internal Revenue ... 197
Where to file ... 15
RETURNS OF CORPORATIONS:
Amended ... 80
Books of account ... 196
By receivers ... 81
Designating fiscal year ... 77
Dissolved corporation ... 82
Due date of ... 76
Extension of time to file ... 78
Failure to file, penalty ... 78
False or fraudulent ... 78
Form of return ... 75
Holding companies ... 80
How executed ... 76
Incompletely organized corporation ... 80
In liquidation ... 82
Insurance companies ... 75
Interstate commerce ... 83
Publicity of ... 79

RETURNS OF CORPORATIONS—*Continued*
Refusal to file ... 79
Subsidiary companies ... 81
Suggestions as to preparation of ... 196
Tentative ... 80
When due ... 76
When Internal Revenue officer will prepare return ... 79
When tax payable ... 76, 78
Where filed ... 76
RETURNS OF INDIVIDUALS:
By agent ... 13
By husband and wife ... 12
Books of account ... 196
Citizen residing abroad ... 15
Delayed ... 16
Extension of time to file ... 16
Fiduciaries ... 12
Form of return ... 11
Failure to file, penalty ... 16
False or fraudulent ... 17
Liability of agent making return ... 13
Refusal to file ... 17
Verification of ... 15
When due ... 16
Where filed ... 15
When Internal Revenue officer will prepare ... 17
Who is required to make return ... 10
Returns, conditions of inspection of ... L. 240
Returns, monthly, under Excise Tax ... L. 270
Returns of exempt organizations ... 86
Returns of fiduciaries ... 12
Returns of nonresident aliens ... 15
RETURNS OF GENERAL PARTNERSHIPS:
Accrual basis ... 68
Credits on ... 70
When required ... 68
RETURNS OF LIMITED PARTNERSHIPS:
Same as corporations ... 70
Returns of private banks ... 14
Revenue Law, War ... L. 249
"Rights," sale of ... 30
Royalties received and paid ... 202

SALARIES:
Based on stockholdings ... 208
Bonuses ... 108
Commissions ... 207
Exempt ... 51, L. 222
Information at source ... 63, 64
National Guardsmen ... 110
Officers ... 208
Paid by stock ... 32
Received from exempt corporation ... 32

SALARIES—*Continued*
When returnable 31
Sale, agreement of: War Tax on ..... L. 276
SALES:
Account of (merchandise) 198
Capital stock sold at premium 94
Freight on 200, 209
Instalment business 94, 98
Profit on sales of capital assets 33, 34, 35
Real estate development corporation 94
Reserve for discounts on sales of commodities 103
Sales of capital assets 33, 91
Sales of property acquired prior to March 1, 1913 34
Salesmen, commissions of 33
Salesmen, expenses of 110
Salvage value of goods returned 98
Scrip dividends 30
Second assessments 79
Secured debts, interest on 104
SECURITIES:
Dividends paid by 23, 91
Fair market value of 35
Inventory valuations by dealers 167
Profit or loss on, acquired prior to March 1, 1913 35
Service connections, water company 111
Services, professional, when returnable 33
Shafting, depreciation of 184
Ships, depreciation of 192
Shipwrecks, losses by ..... L. 222
SICKNESS:
Extension of time to file return on account of 78
Corporations 78
Individuals 16
Return by agent 13
Single or married status 51
Sinking fund, not deductible 103
Sinking fund, interest on, is income 92
Source, information at 63
Source, return of tax withheld at 63
Specific exemptions (*see* "Exemptions, specific").
Spirits, War Tax on distilled ..... L. 258
Sporting goods, War Tax on ..... L. 269
Stable equipment, depreciation of 186
Stamp Taxes, War ..... L. 272
STATE:
Compensation of employees of 51
Contractor doing work for 40
Definition of ..... L. 240
Interest on obligations of 40
STATUTE OF LIMITATIONS:
Claims for refund under old law 18
Recovery of tax paid 59
Return may be made by Internal Revenue officer within three years 17

Steam piping, depreciation of 184
Steam turbines, depreciation of 184
Stock assessment, payment of, not deductible 57
Stock assessment, not income of corporation 58
STOCK, CAPITAL:
Called for by, return 212
Sales of, not income 94
Sales of rights to subscribe to 30
STOCK:
Depreciation of 187
Dividends on 21
Exchange of 27
Interest on preferred 104
Purchases and sales of same issue 26
Record owner of, not actual owner 46
Salary paid by 32
Stock received in reorganization 29
STOCK ON HAND:
Account of 201
Depreciation of 188
Value of 167
Stock rights, sales of 30
Stockholders' responsibility for undivided surplus 20
Stockholder, return of capital to 24, 31
Stocks and bonds, fluctuation in value of 56
Subdivision, political, defined 40
SUBSIDIARY COMPANIES:
Income of 81
Where to file returns of 81
Suggestions, bookkeeping 196
SUMMONS:
Collector has authority to summons taxpayer or other person in connection with his examinations ..... L. 242
Sunday or legal holiday, last day falling on 76
Sundry expense accounts 209
Supertax (*see* "Additional tax").
SURPLUS:
Account of 215
Beyond reasonable needs of corporation 20, 74
Dividends charged to 215
Undistributed surplus tax 73
Undivided ..... 20, 73, L. 221
Surtax (*see* "Additional tax").
Suspense items not deductible 103
Switchboards, depreciation of 184
"System of accounts for retail merchants" 189

Table of Income and War Income Taxes on various amounts 10
Tax paid under protest 59
TAX-BILLS:
Corporations 76
Individuals 17
Tax-free covenant bonds, interest subject to withholding ..... 62, L. 229

TAX ON CORPORATION:
Assessment, notice of ... 76
Calendar year ... 76, L. 230
Delayed payment of tax, penalty, etc ... 76
Fiscal year ... 77, L. 230
Local benefits ... 110
Rates ... 72, L. 230
Receipt for taxes paid ... 17
Undistributed surplus tax ... 73
When due ... 76
TAX ON INDIVIDUALS:
Assessment of tax ... 17
Additional tax ... 2, 4, 5
Calendar year ... (note) 11
Claims for abatement and refund ... 17
Delayed payment of, penalty ... 17, L. 228
Examples of computing ... 6, 7, 8, 9
Income Tax, not deductible ... 53
Normal tax ... 2, 3
Rates of ... 2, 3, 4, 5
Tax exempt income ... L. 221, L. 233
Who is subject to income tax ... 1
Who is subject to war income tax ... 3
Who is subject to excess profits tax ... 117
When due ... 17, L. 228
When 50 per cent penalty is added ... 16
TAXES:
Accounts of ... 212
Deductible ... 53
Examples of computing ... 6, 7, 8, 9
Inheritance tax ... 58
Local benefits ... 53
On bank stock ... 58
Taxes paid by tenant ... 58
See "Normal Taxes."
See "Additional Taxes."
See "Undistributed Surplus Tax."
See "Excess Profits Tax."
See "Corporation Capital Stock Tax."
Withheld tax, creditable ... 52, L. 224
TENANT:
Buildings erected by ... 180
Improvements made by ... 180
Taxes paid by ... 58
Tentative returns ... 80
Theatrical costumes, depreciation of ... 188
Three year limitation, collector may make return within ... 17
Timber lands, depletion of ... 182
Tobacco, War Tax on ... L. 264
Tools, depreciation of ... 184
Toys, War Tax on ... L. 269
TRADE:
"In trade," defined ... 55

TRADE—*Continued*
Income, in trade 54
Losses, in trade 54
Trade-marks, depreciation of 188
Transportation charges 200
Transportation, War Tax on ..... L. 265
Traveling abroad, extension of time 16
Treasury Regulations, Corporation Capital Stock Law Tax ..... L. 286
Treasury Stock 212
Trucks, auto, depreciation of 186
TRUSTEES:
Compensation of 33
Returns by ..... 12, L. 227
Trust estate undistributed for period of years 38
Trusts (*see* "Fiduciaries").
Turbines, depreciation of 184

UNDISTRIBUTED INCOME:
Of corporations 73, 74
Of estates 37, 38
Of partnerships 69
Subject to additional tax ..... 20, L. 221
Undistributed surplus tax ..... 73, L. 231
United States, defined ..... L. 240

Value, fair market 35
VERIFICATION OF RETURNS OF:
Corporations 76
Individuals 15
Military and Naval Service 15
Vested interest, agent required to report distributed and undistributed income 37
Voluntary assessment of stockholders 57, 92

Wages (*see* "Salaries").
War Estate Tax ..... L. 278
War Excess Profits Tax (*see* "Excess Profits Tax").
War Income Taxes, when effective 1
War Revenue Law ..... L. 249
Ward, *cestui que trust*, exemption of 51
Water company, service connections of not exempt 111
Water rates on rented property 53
Who is subject to Income Tax 1
Who is subject to War Income Tax 3
Who is subject to War Excess Profits Tax 117
Wife assumes nationality of husband 66
WITHHOLDING TAX:
Amended law in re 60
Dividends to nonresident aliens not subject to ..... L. 229
Income subject to 60
Indemnity of withholding party 63
Information at source, substituted for 63
Nonresident aliens subject to ..... 60, L. 228

WITHHOLDING TAX—*Continued*
Nonresident foreign corporations subject to.....60, L. 238
Normal tax only subject to withholding.....L. 230
Release of taxes withheld.....63, L. 247
Returns of taxes withheld..... 63
Stock dividend to nonresident foreign corporation..... 66
Tax exempt clause in bonds.....62, L. 229
Tax withheld creditable.....52, L. 224
Wires and cables, depreciation of..... 184
Worthless accounts receivable..... 213
Worthless stocks and bonds..... 187

Yachts and pleasure boats, War Tax on.....L. 270

Printed in the United States of America

SUPPLEMENT TO

INCOME TAX—LAW AND ACCOUNTING

1918

BY

GODFREY N. NELSON

MEMBER OF THE NEW YORK BAR
CERTIFIED PUBLIC ACCOUNTANT, STATE OF NEW YORK

CONTENTS

PART I. INCOME TAX
PART II. EXCESS PROFITS TAX

All page references herein, unless otherwise stated, are made to INCOME TAX—LAW AND ACCOUNTING, 1918

New York
THE MACMILLAN COMPANY
1918

All rights reserved

COPYRIGHT, 1918
BY THE MACMILLAN COMPANY
Set up and electrotyped. Published April, 1918.

SUPPLEMENT TO INCOME TAX—LAW AND ACCOUNTING

PART I

INCOME TAX

Since the publication of **Income Tax—Law and Accounting,** 1918 (January 2, 1918), the Treasury Department has issued Regulations No. 33, Revised, containing two hundred and seventy-five articles. With few exceptions these articles are a restatement of the subject-matter of Treasury Decisions previously promulgated, or elucidations thereof, and are dealt with in the text of **Income Tax—Law and Accounting.**

Individual Tax Returns.—Returns upon Form 1040 should be made by persons having a net income of more than $3,000 for the year 1917, and persons having a net income of $3,000 or less should make returns upon Form 1040 A.

Form 1040 A, although less elaborate in detail, is made up on the same basis as that of Form 1040. Hence, the explanations herein, with reference to items called for by Form 1040, may be applied also to Form 1040 A, in so far as the returns call for like income and deductions.

Form 1040 A calls for "cash received" from sales of merchandise, and from other sources, but that does not prevent those who keep books of account from making returns thereon upon the accrual basis. (See pages 196 to 198.)

FORM 1040

Block A

Parent—Minor Child.—According to regulation of the Treasury Department, a parent is required to report the income of a minor child thereby subjecting the salary of such minor to

the excess profits tax by assessment against the parent if the aggregate net income of Block A exceeds $6,000. A self-supporting minor, who has a taxable income, in the writer's opinion, should be capable of making, and should be permitted to make, his own return.

"The parent is held to be the natural guardian of a minor child. Income received by the minor child from sources other than the parent should be included by the parent in his return of income. The fact that such income is not appropriated by the parent is immaterial, as it will be held, in the absence of a showing of fact to the contrary, that such income was subject to appropriation and was appropriated by the parent, and that the child receives the same as a gift from the parent. Where the income is from a separate estate and the parent has been appointed guardian and the conditions are such that the income so received is to be held for the use of the child, it shall not be included in the return of income of the parent, but shall be accounted for otherwise for the purposes of the income tax in manner and form as called for by the facts of the particular case." (Regulation 33, Article 29.)

Salary Deduction—Invested Capital. Where, under Article 39 of the Excess Profits Tax Regulations ("Salary allowance to partnerships and individuals," page 169) salaries have been deducted from the returns of individuals or partnerships, such salaries must be reported in Block A.

Bonus.—A bonus received in the nature of compensation is deductible by the payer and must be reported by the recipient. A bonus that is not deducted by the payer need not be reported by the recipient. ("Bonuses," pages 108–110.)

Commissions of Salesmen.—These should be reported in Block A and expenses incurred in the nature of traveling, hotel and incidental selling expenses should be deducted in column 5.

Professional Fees.—These should be reported in column 4 and all expenses in connection with the practice of the profession are deductible in column 5, such as, salaries of assistants, rent, light and heat of office, depreciation of equipment used, if any, etc. Such deductions should be explained on the last line of Block A.

Block B

Gross Sales.—As no provision is made for goods returned, allowances and discounts allowed to customers, these should be deducted from the "gross sales" for the purpose of the return. ("Return Sales," etc., page 199.)

Salary.—A salary allowed to the proprietor under Article 39 of the Excess Profits Tax Regulations, should be stated as a deduction in the first item under "Other Business Deductions."

Block C

Losses.—Losses, in excess of profits, on transactions not in the trade or business of the taxpayer are not deductible. Dealers in real estate, stocks, bonds, etc., should make their return in Block B. ("Losses not in business or trade," page 54.)

A "dealer" in securities is one who buys and sells securities and deals therein as a commodity; for example, as a merchant buys and sells merchandise. An investor is not a "dealer."

Block D

Depreciation.—Depreciation of rented property should be included in item 4 and explained in the Block at the foot of page 3. ("Buildings," page 178.)

Block E

Liberty Bonds Issued since September 24, 1917.—The amount to be entered in column 5 should be the same percentage of the actual amount paid for the bonds as the amount in column 3 is of the total amount received. For example, a taxpayer has purchased $100,000 worth of bonds which, on the accrual method, had earned, say, three months' interest, $1,000. Of this amount he is required only to report in column 3, the interest on $95,000 or $950. If he had borrowed $60,000 for the same period of time, on which he paid 6%, namely, $900, he would enter in column 5 only 950/1000ths or 19/20ths of $900, namely, $855. The amount to be entered in column 7 would be $950 less $855 or $95.

It should be noted that the taxpayer is entitled to a deduction

of $5,000 for each member of the family owning that amount of bonds. ("Interest—Liberty Bonds, 4%," page 41.)

Block F

Dividends are taxable at the rates of surtaxes applicable to the period in which the same was accumulated by the corporation, subject, however, to provision of Act of 1917 that dividends declared and paid in 1917 are deemed to have been declared and paid out of the most recently accumulated earnings. (For illustration, see page 22.)

In computing the tax upon dividends paid out of accumulated earnings of years 1913 to 1916, inclusive, it has been ruled by the Department that the amounts thereof shall be added to the income of the year in which the dividends are reported by the recipient and not to the income of the year during which the earnings were accumulated. For example, assuming that the net income as shown by line 0 of the return for 1917 was $38,000; that column 5 of Block F showed dividends accumulated in 1916 of $5,000; that column 4 for 1915 showed $10,000, the taxes thereon would be computed as follows:

Net Income (line 0) for 1917	$38,000	
Dividends (1916) per column 5	5,000	
Total	$43,000	
$38,000 to $40,000 = 2,000 @ 1%		$ 20.00
40,000 to 43,000 = 3,000 @ 2%		60.00
Surtax on 1916 dividends		$ 80.00
Dividends (1915) per column 4	10,000	
Total	$53,000	
$43,000 to $50,000 = 7,000 @ 1%		70.00
50,000 to 53,000 = 3,000 @ 2%		60.00
Surtax on 1915 dividends		$130.00
Total surtax on dividends received out of accumulated surplus of 1916 and 1915		$210.00

Dividends paid to stockholders constitute income to them of the year received by them. The method adopted by the Treasury Department for the taxing of such dividends is no doubt the most practicable; to have used as a base the income of the years during which the earnings were accumulated by the corportion would have incurred a prohibitive task in point of detail work, in the verification of returns.

Stock dividends, by express provision of the Acts of 1916 and 1917 are taxable to the recipients.

Under the Act of 1913, which contained no provision for the taxing of stock dividends, it was ruled by the Department that such dividends were taxable as income. In the case of Henry R. Towne vs. Mark Eisner, Collector, the United States Supreme Court held (January 7, 1918) that stock dividends, under the Act of 1913, were not taxable. Since that decision was rendered, the Commissioner of Internal Revenue has issued a statement that the Department will continue to be governed by the express provisions of the Acts of 1916 and 1917 and will assess stock dividends as taxable income.

Until there has been a Court decision under the present statute the Treasury Department must enforce the law as it exists and stock dividends will be assessed. A taxpayer who takes issue with the Department may omit the stock dividend from his return as taxable income but he should report the item by attaching to the return, securely fastened, a statement of such dividends, why the item is not included in the return proper, etc. Failure to report income taxable under the law, which stock dividends now are, may subject the taxpayer to a penalty in the event that the Court's decision, under present law, should be different from that rendered under the Act of 1913.

Block G

Deductions should not be made of tax withheld in column 2 because that will reduce the deductible amount in line 31 of the return.

Block H

Income from partnerships should be entered in Block H, but only that part thereof which was earned by the partnership in

1917. Earnings of a partnership of 1916 should either be reported in an amended return for that year or the amount of the tax due thereon may be entered as a supplemental item on line 37. If the latter method be used, a statement explaining the item should be attached to the return.

Block J

Take notice that "Excess of Interest Paid, if any" per column 6 of Block E is here deductible.

Block L

This deduction should include the excess profits tax assessments computed upon Forms 1040 and 1101, separately stated on lines 34 and 35 of Form 1040.

Block N

In computing the amount deductible as contributions to charitable organizations the income from dividends accumulated in prior years (Block F) may be added to item M.

Proof of Total Tax

It is suggested that the total assessment, per line 36, be proved by computing the tax as outlined on pages 6 to 9, inclusive (Income Taxes), and 143 to 145, inclusive (Excess Profits Taxes).

Corporation Income Tax Return

The preparation of Form 1031 is dealt with, in detail, in Chapter VII, pages 196 to 218.

Dividends received by corporations (page 75) are taxable at the rates applicable to the year in which they were earned by the declarant corporation; those of 1913, 1914 and 1915 are subject to a tax of 1 per cent and 1916 and 1917, to 2 per cent.

As the tax of 4 per cent is applicable only to the income earned in 1917, a corporation making its return for a fiscal year ended in 1917 should prorate its income according to the number of months falling in the year 1917 (line 11) and the 4 per cent rate should be computed thereon (line 15).

The last bracket of the supplementary statement calls for data that does not enter into the assessment of taxes for the year 1917. In the case of a corporation having the calendar year as its fiscal year, the following information would be required:

1. Net income of the year 1916 (less income tax paid thereon).
2. Amount thereof remaining undistributed June 30, 1917.
3. Amount thereof remaining undistributed December 31, 1917.
4. Total amount of surplus at close of year 1917.

Partnership Returns of Income

All domestic partnerships having a net income of $6,000 or more, without deducting salaries of partners or interest paid to partners, must make returns on Form 1065.

Block A, in addition to income from professions, commissions and personal services, calls for the total amount of assets and liabilities. Only assets actually employed in the profession or occupation at the close of the taxable year should be stated.

Block B. Comments under "Block B" of Form 1040, apply also to partnerships. The salaries of partners are required to be listed in Block L.

Blocks C, D and E. Comments upon these items in the individual return (Form 1040) are also applicable to those in Form 1065.

PART II

EXCESS PROFITS TAX

The returns required to be filed under the Excess Profits Tax are:

Individuals, Form 1101
Partnerships, " 1102
Corporations, " 1103

In many instances the Excess Profits Tax returns refer to Articles of Regulations No. 41. In order to afford a ready reference, the complete text of the regulations have been incorporated herein, with explanatory foot-notes.

REGULATIONS NO. 41

RELATIVE TO THE

WAR EXCESS PROFITS TAX

Imposed by Title II, Act of October 3, 1917

TABLE OF CONTENTS

	Articles
Definitions	1- 9
Corporations, partnerships, and individuals subject to the tax	10-13
Rates and computation of tax	14-20
Computation of the deduction	21-24
Net income—General provisions	25-27
Net income—Corporations	28-29
Net income—Partnerships	30-34
Net income—Individuals	35-41
Invested capital—General provisions	42-52
Invested capital—Corporations and partnerships	53-65
Invested capital—Individuals	66-70
Nominal capital	71-74
Returns	75-78
Assessment and collection	79

DEFINITIONS

1 ARTICLE 1. **Definitions.**—When used in these regulations the terms defined in articles 2 to 9, inclusive, shall, unless otherwise indicated by the context, be deemed to be used only with the scope or meaning ascribed to them respectively in such articles.

2 ART. 2. **Corporation.**—The term "corporation" includes joint-stock companies or associations, no matter how created or organized, insurance companies, and limited partnerships.

3 ART. 3. **Domestic and foreign.**—The term "domestic" means created under the law (statutory or other) of the United States or any State thereof, Alaska, Hawaii, or the District of Columbia, and the term "foreign" means created under the law (statutory or other) of any other possession of the United States or of any foreign country or government.

4 ART. 4. **United States.**—The term "United States" (when used in a geographical sense) means only the States thereof, Alaska, Hawaii, and the District of Columbia.

5 ART. 5. **Taxable year.**—The term "taxable year" means the 12 months ending December 31 of each year, except in the case of a corporation or partnership which has fixed its own fiscal year, in which case it means such fiscal year. The first taxable year is the year ending December 31, 1917, except that in the case of a corporation or partnership which has fixed its own fiscal year, the first taxable year is the fiscal year ending during the calendar year 1917. (For special provisions as to prorating the amount of tax due for the portion of any fiscal year ending during the calendar year 1917, see articles 19 and 20.) [1]

6 ART. 6. **Prewar period.**—The term "prewar period" means the calendar years 1911, 1912, and 1913, or if a corporation or partnership was not in existence or an individual was not engaged in the trade or business during the whole of such three years, then as many of such years during the whole of which the corporation or partnership

[1] Example on page 119, "Taxable year."

was in existence or the individual was engaged in the trade or business.[2]

7 ART. 7. **"Trade," "business," "trade or business" in case of corporations and partnerships.**—In the case of a **corporation or partnership** all income from whatever source derived is deemed to be received from its trade or business, and the terms "trade," "business," and "trade or business" include all sources of income.[3]

8 ART. 8. **"Trade" in the case of individuals.**—In the case of an **individual,** the terms "trade," "business," and "trade or business" comprehend all his activities for gain, profit, or livelihood, entered into with sufficient frequency, or occupying such portion of his time or attention as to constitute a vocation, including occupations and professions. When such activities constitute a vocation they shall be construed to be a trade or business whether continuously carried on during the taxable year or not, and all the income arising therefrom shall be included in his return for excess profits tax.

9 In the following cases the gain or income is not subject to excess profits tax, and the capital from which such gain or income is derived shall not be included in "invested capital": (*a*) Gains or profits from transactions entered into for profit, but which are isolated, incidental, or so infrequent as not to constitute an occupation, and (*b*) the income from property arising merely from its ownership, including interest, rent, and similar income from investments except in those cases in which the management of such investments really constitutes a trade or business.[4]

10 ART. 9. **"Dividend."**—The term "dividend" has the same meaning as in section 31 of the act of September 8, 1916, as amended by the act of October 3, 1917.[5] (See Income Tax Regulations, art. 106.)

[2] "Prewar Period," see page 120.

[3] Profits and income from the sale of capital assets as well as the profits from sales of commodities, are subject to the excess profits tax in the case of a corporation or partnership.

[4] Illustration: "Land owner," page 123.

[5] "Dividends," see page 21.

CORPORATIONS, PARTNERSHIPS, AND INDIVIDUALS SUBJECT TO THE TAX

ART. 10. **Corporations.**—Every domestic corporation which has for the taxable year a net income of $3,000 or more is, unless exempt under article 13, required to make a return and to pay the tax, if any.[6]

Every foreign corporation which has for the taxable year a net income of $3,000 or more from sources within the United States is, unless exempt under article 13,[6] required to make a return and to pay the tax, if any.[7]

ART. 11. **Partnerships.**—Every domestic partnership which has for the taxable year a net income of $6,000 or more is, unless exempt under article 13, required to make a return and to pay the tax, if any.

Every foreign partnership which has for the taxable year a net income of $3,000 or more from sources within the United States is, unless exempt under article 13, required to make a return and to pay the tax, if any.[7]

ART. 12. **Individuals.**—Every citizen or resident of the United States who has for the taxable year an aggregate net income in excess of $6,000 from trades, businesses, occupations or professions is, unless exempt under article 13, required to make a return and to pay the tax, if any.

Every nonresident alien individual who has for the taxable year an aggregate net income of $3,000 or more from trades, businesses, occupations, or professions carried on within the United States is, unless exempt under article 13, required to make a return and to pay the tax, if any.[7]

ART. 13. **Exemptions.**—The following are exempt from the tax:

(*a*) Corporations exempt under the provisions of section 11 of Title I of the act of September 8, 1916, from the tax imposed by such title.[6]

(*b*) Partnerships carrying on or doing the same kind of business or coming within the same description.

(*c*) Individuals to the extent that they carry on or do the same kind of business or come within the same description.

[6] "Exempt Organizations," see page 85.

[7] Note that domestic corporations having a net income of $3,000 or more,

Rates and Computation of Tax

21 ART. 14. **Classification of net income.**—For the purposes of the excess profits tax net income which is subject to the tax shall be divided into two classes, as follows:

22 A. Net income which is derived from a trade or business having no invested capital, or not more than a nominal capital,[8] including in the case of an **individual** salaries, wages, fees, or other compensations; [9] and

23 B. Net income which is derived from a trade or business having invested capital.[10]

24 In the case of a **corporation or partnership,** all the trades and businesses in which it is engaged will be treated as a single trade or business (as provided in sec. 201), and its entire income will be held to be of the same class as the income from its principal trade or business.[11]

25 In the case of an **individual** the net income subject to the excess profits tax shall be classified as provided in this article. Net income of class A shall be taxed as provided in article 15, and net income of class B shall be taxed as porvided in article 16.[11]

and domestic partnerships and citizens or residents of the United States having a net income of $6,000 or more, for the taxable year, are required to make returns, and respectively, under Article 21 (a) and (b) receive specific deductions of $3,000 and $6,000; that foreign corporations and partnerships and nonresident alien individuals, having net incomes of $3,000 or more, for the taxable year, are required to make returns, but, under Article 21 (c), receive no specific deduction. See "Inequity in case of foreign partnership," page 121. The inequality is not remedied by the Regulations.

[8] "Nominal capital" is defined and restricted by Article 74.

[9] See Illustrations, page 133.

[10] For relation of "invested capital" to book values, see page 130.

[11] Take notice that the entire net income of corporations and partnerships is treated as a whole, whereas the income of individuals may be separated and be made subject to the respective rates according to whether actual capital is or is not employed. For example, in the case of a corporation, the principal business of which is manufacturing, earning $10,000 from that source upon invested capital, and $5,000 from sources requiring no invested capital, as commissions, the entire net income of $15,000 would be subject to rates applicable to invested capital; whereas, an individual

26 ART. 15. **Rate of tax on income of class A.**—The tax upon net income of class A as defined in article 14 shall be computed at the rate of 8 per cent upon the amount thereof in excess of $3,000 in the case of a **domestic corporation**; upon the amount thereof in excess of $6,000 in the case of a **domestic partnership** or of a **citizen** or **resident** of the United States; and upon the whole thereof in the case of a **foreign corporation or partnership** or of a **nonresident alien individual.**[12]

27 ART. 16. **Rate of tax on income of class B.**—The tax upon net income of class B as defined in article 14 shall, except as otherwise provided in article 17, be computed at the following rates: [13]

20 per cent of the amount of the net income in excess of the deduction (determined as provided in articles 21, 23, and 24) and not in excess of 15 per cent of the invested capital for the taxable year;

25 per cent of the amount of the net income in excess of 15 per cent and not in excess of 20 per cent of such capital;

35 per cent of the amount of the net income in excess of 20 per cent and not in excess of 25 per cent of such capital;

45 per cent of the amount of the net income in excess of 25 per cent and not in excess of 33 per cent of such capital;

60 per cent of the amount of the net income in excess of 33 per cent of such capital.

28 ILLUSTRATIONS.[12]—(1) A corporation has a capital of $100,000, prewar earnings of 7 per cent, and a net income for the taxable years of $75,000.

The deduction allowed will be 7 per cent of the capital, or $7,000, plus $3,000 specific deduction, a total of $10,000.

conducting a similar business would pay the tax, based on invested capital, upon $10,000 and the fixed rate of 8 per cent upon the amount of earnings requiring no invested capital, as commissions, less the specific exemption.

[12] See foot-note No. 7, herein.

[13] See Illustrations, page 142.

The amount of the net income taxable at each rate will be as follows:

In excess of the deduction and not in excess of 15 per cent of the capital (rate, 20 per cent)	$5,000
In excess of 15 per cent of the capital and not in excess of 20 per cent thereof (rate, 25 per cent)	5,000
In excess of 20 per cent of the capital and not in excess of 25 per cent thereof (rate, 35 per cent)	5,000
In excess of 25 per cent of the capital and not in excess of 33 per cent thereof (rate, 45 per cent)	8,000
In excess of 33 per cent of the capital (rate, 60 per cent)	42,000

The tax would then be computed as follows:

20 per cent of $5,000	$1,000
25 per cent of $5,000	1,250
35 per cent of $5,000	1,750
45 per cent of $8,000	3,600
60 per cent of $42,000	25,200
Total tax	$32,800

29 (2) An individual or partnership has a capital of $100,000, prewar earnings of 8 per cent, and a net income for the taxable year of $22,500.

The deduction allowed will be 8 per cent of the capital, or $8,000, plus $6,000 specific deduction, a total of $14,000.

The amount of the net income taxable at each rate will be as follows:

In excess of the deduction and not in excess of 15 per cent of the capital (rate, 20 per cent)	$1,000
In excess of 15 per cent of the capital and not in excess of 20 per cent thereof (rate, 25 per cent)	5,000
In excess of 20 per cent of the capital and not in excess of 25 per cent thereof (rate, 35 per cent)	2,500

The tax would then be computed as follows:

20 per cent of $1,000	$200
25 per cent of $5,000	1,250
35 per cent of $2,500	875
Total tax	$2,325

30 ART. 17. **When deduction exceeds 15 per cent of invested capital.**—In any case in which the deduction determined as provided in articles 21, 23, and 24 is greater than 15 per cent of the invested capital and therefore can not be fully allowed under the first rate or bracket of article 16, then any remaining portion of the deduction will be allowed under the second bracket, and continued if necessary into

the succeeding bracket or brackets until the entire amount of the deduction is allowed.[14]

31 ILLUSTRATIONS.—(1) A corporation has a capital of $9,000; prewar earnings of 9 per cent; and a net income for the taxable year of $10,000.

The deduction allowed will be 9 per cent of the capital, or $810, plus $3,000 specific deduction, a total of $3,810.

The amount of the net income in each bracket will be as follows:

15 per cent of the capital	$1,350
In excess of 15 per cent of the capital and not in excess of 20 per cent thereof	450
In excess of 20 per cent of the capital and not in excess of 25 per cent thereof	450
In excess of 25 per cent of the capital and not in excess of 33 per cent thereof	720
In excess of 33 per cent of the capital	7,030

It is evident that the total deduction of $3,810 is greater than 15 per cent of the capital and so is not fully absorbed by the amount of net income not in excess of 15 per cent of the capital. In such case, applying article 17, the total deduction of $3,810 will be distributed as follows:

$1,350 in the first bracket, leaving nothing to be taxed at the 20 per cent rate.

$450 in the second bracket, leaving nothing to be taxed at the 25 per cent rate.

$450 in the third bracket, leaving nothing to be taxed at the 35 per cent rate.

$720 in the fourth bracket, leaving nothing to be taxed at the 45 per cent rate.

There still remains $840 of the deduction to be allowed in the fifth bracket against the $7,030 of income which would otherwise be taxable under that bracket. There would then be $6,190 of net income left to be taxed at the 60 per cent rate under the fifth bracket. Hence, the total excess profits tax in this case would be $3,714.

32 (2) An individual or partnership has a capital of $40,000, prewar earnings of 9 per cent, and a net income for the taxable year of $12,000.

The deduction allowed will be 9 per cent of the capital, or $3,600, plus $6,000 specific deduction, a total of $9,600.

The amount of the net income in each bracket will be as follows:

15 per cent of the capital	$6,000
In excess of 15 per cent of the capital and not in excess of 20 per cent thereof	2,000

[14] See Illustrations, page 143.

In excess of 20 per cent of the capital and not in excess of 25 per cent thereof..... $2,000
In excess of 25 per cent of the capital and not in excess of 33 per cent thereof..... 2,000

It is evident that the total deduction of $9,600 is greater than 15 per cent of the capital and so is not fully absorbed by the amount of net income not in excess of 15 per cent of the capital. In such case, applying article 17, the total deduction of $9,600 will be distributed as follows:

$6,000 in the first bracket, leaving nothing to be taxed at the 20 per cent rate.

$2,000 in the second bracket, leaving nothing to be taxed at the 25 per cent rate.

$1,600, the balance of the deduction, to be allowed against the $2,000 of income in the third bracket.

There would then be $400 of income left in the third bracket to be taxed at the 35 per cent rate, and $2,000 in the fourth bracket to be taxed at the 45 per cent rate. Hence, the total excess profits tax in this case would be $1,040.

33 ART. 18. **Constructive Capital for Application of Rates.**—Where the deduction allowed to a taxpayer is determined under article 24, the invested capital for the purpose of applying the rates of taxation under article 16 shall be deemed to be an amount which bears the same ratio to the net income of the trade or business for the taxable year which the average invested capital for the corresponding calendar year of representative corporations, partnerships, and individuals engaged in a like or similar trade or business bears to their average net income.[15]

[15] In the example stated on page 135, the assumed figures show the net profit of representative concerns to be 20 per cent of the capital invested; the "constructive capital" would be $125,000, computed as follows:

30,000,000 : 6,000,000 : : ? : 25,000 =
(30,000,000 × 25,000) ÷ 6,000,000 = $125,000

or, on a percentage basis:

100% : 20% : : ? : 25,000 =
(100 × 25,000) ÷ 20 = 125,000

The tax would then be computed as follows:

Constructive capital.....		$125,000.00
Net Income (20%).....		$ 25,000.00
Deductions:		
In lieu of prewar profit.....	$11,250.00	
Exemption (corporation).....	3,000.00	

34 The Commissioner of Internal Revenue in determining for any calendar year the ratio which the average invested capital of representative corporations, partnerships, and individuals engaged in any particular trade or business bears to their average net income, will include the invested capital and net income of representative corporations and partnerships for fiscal years ending during such calendar year.

35 For the purpose of applying this article in the case of a corporation or partnership which has fixed its own fiscal year, the ratio determined for the calendar year ending during such fiscal year shall be used.

36 ART. 19. **Computation of tax for fiscal year, part of which falls within calendar year 1916.**—If a corporation or partnership prior to March 1, 1918, makes a return for a fiscal year, part of which falls within the calendar year 1916, the tax for the first taxable year shall be that proportion of the tax computed upon the net income for such fiscal year which the number of months from January 1, 1917, to the end of such fiscal year bears to the entire number of months in such fiscal year.[16]

37 ART. 20. **Computation of tax for period of less than 12 months.**—If a corporation or partnership at any time, either because it has just designated a fiscal year as provided

Total deductions		$14,250.00	
Subject to tax		$ 10,750.00	
As follows: On amount not in excess of 15% of capital	$18,750.00		
Less deduction	14,250.00		
Not in excess of 15% of capital	4,500.00	@ 20%	$ 900.00
15 to 20%	6,250.00	@ 25%	1,562.50
Taxable amount	10,750.00		
Total tax			$2,462.50

[16] See Illustration under "Taxable Year," page 119.

in sections 8 or 13 of the act of September 8, 1916,[17] or for any other reason, makes a return for a period of less than 12 months, the deduction will be an amount which bears the same ratio to the deduction allowable for a full year as the number of months in such period bears to 12 months.

Computation of the Deduction

38 Art. 21. **Trade or business having invested capital.**—The deduction used in computing the rates of tax under article 16 shall, except in cases coming within the conditions specified in articles 23 and 24, be as follows:

39 (*a*) In the case of a **domestic corporation** the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (except that 7 per cent shall be used if such percentage was less than 7 per cent, and 9 per cent shall be used if such percentage was more than 9 per cent, and 8 per cent shall be used if the corporation was not in existence during the whole of at least one calendar year during the prewar period),[18] and (2) $3,000.[19]

40 (*b*) In the case of a **domestic partnership** or of a **citizen or resident** of the United States, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (except that 7 per cent shall be used if such percentage was less than 7 per cent, and 9 per cent shall be used if such percentage was more than 9 per cent, and 8 per cent shall be used if the partnership was not in existence or the individual was not engaged in the trade or business during the whole of at least one calendar year during the prewar period), and (2) $6,000.[19]

41 (*c*) In the case of a **foreign corporation or partnership** or

[17] "Apportioning Income for 1917," see page 77.

[18] See page 146.

[19] See example, page 141.

of a **nonresident alien individual,** an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (except that 7 per cent shall be used if such percentage was less than 7 per cent, and 9 per cent shall be used if such percentage was more than 9 per cent; and 8 per cent shall be used if the corporation or partnership was not in existence or the individual was not engaged in the trade or business during the whole of at least one calendar year during the prewar period).[20]

42 ART. 22. **Trade or business reorganized on or after January 2, 1913.**—If a trade or business carried on by a **corporation, partnership or individual** was formally organized or reorganized on or after January 2, 1913, but is substantially a continuation of a trade or business carried on prior to that date, then the corporation or partnership shall be deemed to have been in existence, or the individual shall be deemed to have been engaged in the trade or business, prior to that date, and for the purpose of computing the deduction the net income and invested capital of the predecessor shall be deemed to have been the net income and invested capital of the present owner for the prewar period.[21]

43 ART. 23. **When income for prewar period can not be satisfactorily determined, or when net income was low during prewar period, or when there was no net income during prewar period.**—In the following cases the deduction shall be determined as provided in this article: [22]

44 (*a*) If the Secretary of the Treasury is unable satisfactorily to determine the average amount of annual net income of the trade or business for the prewar period; [23]

[20] Computed on the same principle as in the case of domestic corporations or partnerships, but without the specific exemption of $3,000 or $6,000.

[21] See illustration considered in House of Representatives, page 136.

[22] See pages 146, 147 and 148.

[23] Example: Where records have been lost or destroyed; where no books have been kept.

45 (*b*) If the Secretary of the Treasury upon complaint finds that during the prewar period the percentage of the net income to the invested capital of the taxpayer was lower by 1 per cent or more than the percentage of the net income to the invested capital of representative corporations, partnerships or individuals engaged in a like or similar trade or business during the same period.[24]

46 (*c*) If, in the case only of a **domestic corporation or partnership** which was in existence during the prewar period, or of a **citizen or resident** of the United States who was engaged in the trade or business during the prewar period, the Secretary of the Treasury upon complaint finds that during the prewar period there was no net income from the trade or business.[25]

In such cases the deduction shall be—

47 (1) An amount equal to the same percentage of the invested capital for the taxable year which the average deduction (determined in the same manner as provided in article 21, without including the $3,000 or $6,000 therein referred to) for such year of representative corporations, partnerships, or individuals engaged in a like or similar trade or business, is of their average invested capital for such year,[26] plus

48 (2) In the case of a **domestic corporation,** $3,000, and in the case of a **domestic partnership** or a **citizen or resident** of the United States, $6,000.

49 In cases arising under subdivision (*a*) or (*c*) of this article the tax shall be assessed in the first instance upon the basis of a deduction computed by the use of 7 per cent. In

[24] Take notice that the taxpayer must file complaint in order to avail himself of this provision. Inasmuch as the taxpayer is not assumed to have knowledge of the percentage of net income of representative concerns, he may claim the benefit of such deduction if his net income is less than 9 per cent of invested capital and if he has reason to believe that the net income of representative concerns was greater by one per cent. or more than that shown by him.

[25] See page 146.

[26] These computations will be made by the Commissioner of Internal Revenue and final assessments will be based thereon.

cases arising under subdivision (*b*) the tax shall be assessed in the first instance upon the basis of a deduction determined as provided in article 21.

50 In any case under this article a taxpayer claiming the benefit of this provision shall at the time of making the return file a claim for abatement (Form 47) of the amount by which the tax so assessed exceeds a tax computed upon the basis of the deduction determined as provided in this article. In cases coming within the provisions of this article payment of that portion of the tax covered by the claim for abatement will not be required until the claim is decided. If, however, in the judgment of the Commissioner of Internal Revenue the interests of the United States would be jeopardized thereby, the right is reserved to require the claimant to give a bond of such amount and with such sureties as the commissioner thinks wise to safeguard such interests. The bond shall be conditioned for the payment of any tax found to be due with interest thereon, and if a bond satisfactory to the commissioner is not given within such time as he prescribes, the full amount of the tax assessed will become immediately due and the amount overpaid, if any, will upon final decision of the application, be refunded as a tax erroneously or illegally collected.[27]

51 ART. 24. **When invested capital can not be satisfactorily determined.**—If the Secretary of the Treasury is unable satisfactorily to determine the invested capital, the deduction shall be the sum of—

52 (1) An amount equal to the same proportion of the net income of the trade or business for the taxable year as the average deduction (determined in the same manner as provided in article 21 without including the $3,000 or $6,000 therein referred to) for the corresponding calendar year, of representative corporations, partnerships, and individuals engaged in a like or similar trade or business, is of their average net income, plus

53 (2) In the case of a domestic corporation $3,000, and in

[27] Page 147.

the case of a **domestic partnership** or a **citizen** or **resident** of the United States, $6,000.[28]

54 The Commissioner of Internal Revenue in determining for any calendar year the proportion which the average deduction of representative corporations, partnerships, and individuals engaged in any particular trade or business is of their average net income, will include the deductions and net income of representative corporations and partnerships for fiscal years ending during such calendar year.

55 For the purpose of applying this article in the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used.

56 In every case of a trade or business having invested capital a return shall be made in the first instance in accordance with article 21 or 23, but the taxpayer may submit therewith a statement of reasons why in his opinion the tax should be assessed in accordance with this article.

Net Income—General Provisions

57 Art. 25. **Exemptions.**—The following classes of income are exempt from the tax:

58 (*a*) Income exempt from taxation under section 4 of the act of September 8, 1916, as amended.[29] (See Income Tax Regulations, art. 5.)

59 (*b*) Income derived from the business of life, health, and accident insurance combined in one policy issued on a weekly premium payment plan.

60 (*c*) Compensation or fees received by officers and employees under the United States or any State, Territory, or the District of Columbia for their services as such.

61 Art. 26. **Net income of foreign corporations, partnerships, and nonresident alien individuals.**—In the case of a **foreign corporation** or **partnership** or a **nonresident alien**

[28] "Where invested capital cannot be determined," page 134, and footnote No. 15 herein.

[29] "Tax exempt income," page 221.

individual the net income shall be the net income from sources within the United States.[30]

62 ART. 27. **Dividends received from a foreign corporation which is subject to Federal income tax.**—In the case of income derived by a **corporation** or **partnership** from dividends upon the stock of a foreign corporation, part of whose net income is subject to the income tax, there shall be deducted only that proportion of the dividends received upon such stock which the net income of such foreign corporation from sources within the United States is of its entire net income.[31]

63 Where dividends upon the stock of a foreign corporation are received by an **individual**, as a part of his income from trade or business, there shall be included in the net income that proportion of the dividends received upon such stock which the net income of such corporation from sources outside the United States is of its entire net income.[32]

NET INCOME—CORPORATIONS

64 ART. 28. **Taxable year.**—The net income of a **corporation** for the taxable year shall be determined by adding (1) the amount of net income ascertained and returned for income tax purposes for such taxable year as provided in Title I of the act of September 8, 1916, as amended,[33] and (2) the amount, if any, received as interest on bonds or other

[30] Page 46, "Foreign income of nonresident alien."

[31] Illustration: Dividends, $5,000. Income from sources within the United States, $10,000; without the United States, $15,000; total income $25,000. The exempt dividends would be $2,000 computed as follows:

$10,000 : $25,000 :: ? : $5,000 =

(10,000 × 5,000) + 25,000 = $2,000.

[32] Illustration: Dividends received by an individual as a part of his income from trade or business, $3,000. Income of foreign corporation from sources outside the United States, $5,000; total income from all sources $7,500. The portion of such dividend to be reported as income would be $2,000, derived as follows:

$5,000 : 7,500 :: ? : $3,000 =

($5,000 × 3,000) + 7,500 = $2,000

[33] Page 122, "For the Taxable Year."

obligations of the United States, issued after September 24, 1917 (other than the interest received on an amount of such bonds or obligations the aggregate principal of which does not exceed $5,000),[34] and deducting from the total so obtained the amounts received during the taxable year as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the income tax imposed by Title I of such act of September 8, 1916, as amended, except as otherwise provided in article 27.

65 ART. 29. **Prewar period.**—The net income of a corporation for the prewar period shall be computed as follows:

66 (*a*) For the calendar year 1911 by adding (1) the amount of net income shown in item 9 of the return made under section 38 of the act of August 5, 1909, for the calendar year 1911, and (2) the amount of taxes paid to the United States *within* the calendar year 1911 under section 38 of such act; [35]

67 (*b*) For the calendar year 1912 by adding (1) the amount of net income shown in item 9 of the return made under section 38 of the act of August 5, 1909, for the calendar year 1912, and (2) the amount of taxes paid to the United States *within* the calendar year 1912 under section 38 of such act; and [35]

68 (*c*) For the calendar year 1913 by adding (1) the amount of the entire net income shown in item 8 of the return made under Section II of the act of October 3, 1913, for the calendar year 1913, and (2) the amount of taxes paid *within* the calendar year 1913 under section 38 of the act of August 5, 1909, and Section II or IV of the act of October 3, 1913, and deducting from the total so obtained the amounts received during the calendar year 1913 as dividends upon the stock or from the net earnings of other corporations, joint-stock companies or associations, or insurance companies, subject to the income tax imposed by Section II of the act of October 3, 1913.[35]

[34] Page 41 "Interest Liberty Bonds, 4%."

[35] Page 122, "For 1911 and 1912" and "For 1913."

NET INCOME—PARTNERSHIPS

69 ART. 30. **Taxable year.**—The net income of a **partnership** for the taxable year shall be determined by adding the amount of its entire net income (or in the case of a foreign partnership, its entire net income from sources within the United States) ascertained upon the same basis and in the same manner as provided with respect to individuals for income-tax purposes by Title I of the act of September 8, 1916, as amended [36] (see Income Tax Regulations, art. 30), including the amounts, if any, received during the year as interest on bonds or other obligations of the United States issued after September 24, 1917 (other than the interest on an amount of such bonds or obligations, the aggregate principal of which does not exceed $5,000),[37] and deducting therefrom—

70 (1) The amounts received during the taxable year as dividends upon the stock or from the net earnings of corporations, joint-stock companies or associations, or insurance companies, subject to the income tax imposed by Title I of the act of September 8, 1916, as amended, except as otherwise provided in article 27; and

71 (2) The deductions, if any, for salaries or interest allowed by articles 32 and 33, if such deductions have not already been made.

72 ART. 31. **Prewar period.**—The net income of a **partnership** for each of the calendar years 1911, 1912, and 1913 shall be determined in the same manner as the net income for the taxable year, except that dividends upon the stock or from the net earnings of corporations, joint-stock companies or associations, or insurance companies, subject to the tax imposed by section 38 of the act of August 5, 1909, or by Section II of the act of October 3, 1913, shall be deducted. (See art. 30.)

73 ART. 32. **Deductions allowed for salaries paid to partners.**—In computing net income for purposes of the excess profits tax a **partnership** will be allowed to deduct as an

[36] Form 1065.
[37] Page 41.

expense reasonable salaries or compensation paid to individual partners for personal services actually rendered during the taxable year, if the payments are made in accordance with prior agreements and are properly recorded on the books of the partnership. In no case shall the salaries or compensation so deducted be in excess of the salaries or compensation customarily paid for similar services under like responsibilities by corporations engaged in like or similar trades or businesses.[38]

74 With respect to any period prior to March 1, 1918, regardless of whether a previous agreement has been made as to salaries or compensation, a similar deduction will be allowed for services actually rendered.

75 In the case of a foreign partnership the deduction shall be limited to those portions of salaries or compensation which are paid for services rendered with respect to trade or business carried on in the United States.

76 A partner in his individual capacity is, however, subject to the excess profits tax, if any, at the 8 per cent rate under article 15 with respect to any salary or compensation from the partnership for personal services (including any amounts allowed to the partnership as a deduction on his account for the period prior to March 1, 1918).

77 ART. 33. **Deductions allowed for interest on bona fide loans by partners.**—In computing net income for purposes of the excess profits tax a **partnership** will be allowed to deduct amounts paid during the year to an individual partner as interest upon any bona fide loan, but no deduction for so-called interest upon capital will be allowed.[39]

78 ART. 34. **If deduction is made under article 32 or 33, corresponding deduction must also be made for prewar period.**—If, in computing net income for purposes of the excess profits tax, a **partnership** makes a deduction as allowed by article 32 for salaries paid to partners during the taxable year, it must also in computing net income for the prewar period make a corresponding deduc-

[38] Page 169 "Salary allowances," etc.

[39] Interest paid upon capital is a distribution of profits and not deductible. Page 171, "Interest on Loans," etc.

tion; [40] and if it makes such a deduction as allowed by article 33 for interest paid to partners, it must also in computing net income for the prewar period make a corresponding deduction for any such interest actually paid during that period.

NET INCOME—INDIVIDUALS

79 ART. 35. **Determination of net income where there is no invested capital or only nominal capital.**—The net income which is derived from a trade or business having no invested capital or not more than a nominal capital, including salaries, wages, fees or other compensations (constituting net income of class A as defined in art. 14) shall be determined for the taxable year by adding the total net income from all such sources (or in the case of a **nonresident alien individual** the total net income from all such sources within the United States) as reported for income tax purposes for the same year.[41]

80 ART. 36. **Determination of net income for taxable year when there is invested capital.**—The net income which is derived from a trade or business having invested capital (constituting net income of class B, as defined in art. 14) shall be determined for the taxable year by adding the total net income from such sources (or in the case of a **nonresident alien individual** the total net income from such sources within the United States) as reported for income tax purposes for the same year and deducting therefrom the deduction, if any, for salary allowed by article 39, if such deduction has not already been made.[42]

81 There shall be excluded the amounts received during the year upon the stock or from the net earnings of corporations,

[40] "Corresponding deduction" does not mean that the same amount or amounts must be used for the prewar period; an amount that would have been customarily paid for services rendered during that period, under like responsibilities, will answer the requirements of this provision.

[41] Article 35 refers to income called for by Block A, page 3, of the Income Tax Return (Form 1040).

[42] Article 36 refers to net income from trade or business as shown by Block B of the Income Tax Return (Form 1040).

joint-stock companies or associations, or insurance companies, subject to the income tax imposed by Title I of the act of September 8, 1916, as amended.[43]

82 In the case, however, of an individual dealing in securities or otherwise using securities in trade or business there shall be included (1) the amount, if any, received as interest on bonds or obligations of the United States, issued after September 24, 1917 (other than the interest received on an amount of such bonds or obligations the aggregate principal of which does not exceed $5,000), and (2) such proportion of dividends received upon the stock of foreign corporations as is required to be included by article 27.

83 ILLUSTRATION.—An individual owns a farm representing an invested capital of $25,000, a country store with an invested capital of $6,000, and a flour mill with an invested capital of $10,000. His net income from the farm is $4,000, from the store $3,000, and from the mill $3,000. Thus his total net income of class B is $10,000. His total invested capital is $41,000. Assuming that his deduction is at the rate of 8 per cent, his total deduction will be $3,280 plus $6,000, or $9,280, to be applied against his net income of $10,000 in computing the tax at the graduated rates under articles 16 and 17.

The same individual allows himself a salary of $1,000 for working the farm and $900 for running the store, draws a salary of $1,200 as president of the local bank, and receives $250 in compensation for personal services of various kinds, such as road work, helping neighbors in harvest, etc. He also receives $300 in dividends on an investment in certain stocks and $100 as supervisor's fees. The last item—that is, supervisor's fees—is exempt under the law (sec. 201, subdivision a). The $300 in dividends is not taxable, inasmuch as it is derived from a mere investment not connected with his trade or business. His net income of class A will therefore consist of his salaries and his compensation for personal services, a total of $3,350. Since he is entitled to a deduction of $6,000 as to this class of income, he will have no tax to pay at the 8 per cent rate under article 15.[44]

84 ART. 37. **Deduction of contributions for religious, charitable, etc., purposes.**—Contributions or gifts for religious,

[43] Block F of Form 1040.

[44] It should be noted that the taxpayer is given credit for the specific exemption of $6,000 under each class of income, A and B. This is applicable only to individuals; as to corporations and partnerships see footnote No. 11 herein.

charitable, etc., purposes allowed as a deduction for purposes of the income tax under paragraph "Ninth" of subdivision (a) of section 5 of the act of September 8, 1916, as amended, may, subject to the limitations therein contained, be deducted in computing the net income of the trade or business for purposes of the excess profits tax only when it is shown to the satisfaction of the Commissioner of Internal Revenue that such contributions or gifts are made by the trade or business and not by the individual in his personal capacity.[45]

85 ART. 38. **Determination of net income for the prewar period where there is invested capital.**—The net income which is derived from a trade or business having invested capital (constituting net income of class B as defined in article 14) shall be determined for each of the calendar years 1911, 1912, and 1913 upon the same basis and in the same manner as provided in article 36.[46]

86 ART. 39. **Deduction allowed for salary to himself.**—An individual carrying on a trade or business having an invested capital may in computing the net income of the trade or business for purposes of the excess profits tax deduct a reasonable amount designated by him as salary or compensation for personal service actually rendered by him in the conduct of such trade or business. In no case shall the amount so designated be in excess of the salaries or compensation customarily paid for similar service under like responsibilities by corporations or partnerships engaged in like or similar trades or businesses.[47]

87 In the case of a **nonresident alien individual,** the amount

[45] "Shown to the satisfaction of the Commissioner of Internal Revenue" means only that he must be satisfied if the item is questioned. Where an individual is conducting a trade or business and makes contributions to charities out of the funds of such trade or business and such payments are treated as business expenses and not as direct charges to the proprietor, the deduction is justified. The deduction is not applicable to corporations or partnerships. Page 52 "Contributions to Charities."

[46] The basis employed in computing the net income for the taxable year must also be used in computing the net income of prewar years.

[47] Page 169 "Salary allowance to Individuals."

deducted shall be limited to that portion of the salary or compensation which is for service rendered with respect to trade or business carried on in the United States.

88 The amount so designated shall, however, be included in computing his net income of class A under article 35; and the balance of the income from his trade or business shall be included in computing his net income of class B under article 36.

89 ILLUSTRATION.—An individual owns and runs a newspaper having an invested capital of $50,000. The net income from the newspaper, without making any allowance for the salary of the owner, is $20,000, and, as income of class B, is subject to the graduated rates prescribed in article 16. His deduction, as provided for in subdivision (*b*) of article 21, would be $4,500 (9 per cent of his capital) plus $6,000, a total of $10,500. If, however, he allows himself a salary of $3,000, the net income from the newspaper will be $17,000, and the deduction of $10,500 will be applied against that amount.

His salary of $3,000 must be included in his return as income of class A, which is subject to the 8 per cent rate under article 15. If it constitutes his only income of that class he will pay no tax thereon, inasmuch as it is less than the deduction of $6,000 to which he is entitled as to that class of income. But if, for example, he receives in addition a salary of $4,000 as president of the local bank, his total net income of class A will be $7,000, and he will be required to pay a tax of 8 per cent on $1,000 thereof, or $80.

90 ART. 40. **If deduction is made under article 39 corresponding deduction must also be made for prewar period.**—If, in computing net income for purposes of the excess profits tax, an individual deducts a reasonable amount designated as salary or compensation for personal services rendered by himself, as allowed by article 39, he must also in computing net income for the prewar period, made a corresponding deduction.[48]

91 ART. 41. **Individual member of partnership.**—Inasmuch as a partner in his individual capacity is not considered to be engaged in trade or business with respect to his share in the profits of the partnership, he is not subject to excess profits tax thereon. Consequently, in computing his net income for purposes of the excess profits tax he need not include his share of the partnership profits.[49]

[48] See footnote No. 40, herein.

[49] Page 171, "Profits derived by Partners from Partnership."

92 He shall, however, in computing his net income of class A under article 35, include any salary or compensation from the partnership for personal services (including any amount allowed to the partnership as a deduction on his account for the period prior to March 1, 1918, in accordance with article 32).[50]

Invested Capital—General Provisions

93 Art. 42. **Allowance for depletion, depreciation, and obsolescence in computation of invested capital.**—The term "invested capital" as used in the excess profits law tax means the invested capital of the present owner. The basis, or starting point, in the computation of invested capital is found in the amount of cash and other property paid in, the original values of such other property being determined in accordance with the rules laid down in these regulations. But the computation does not stop with such original entries or amounts; it must take properly into account the surplus and undivided profits. In the computation of surplus and undivided profits, however, full recognition must first be given to expenses incurred and losses sustained from the original organization of the business concern down to the taxable year, including among such expenses and losses a reasonable allowance for depletion, depreciation, or obsolescence of property originally acquired for cash or for stock or shares or in any other manner. If value appreciation of a kind not subject to income tax (other than that allowed under article 55) has been taken up in the accounts, a deduction must be made in respect of such appreciation so taken up. In the computation of the invested capital for any year full effect must also be given to any liquidation of the original capital.[51]

94 Art. 43. **How to ascertain average invested capital for the year, averaged monthly.**—The invested capital for any prewar or taxable year (or where the tax is computed upon the basis of a period less than a year, for such period) is the

[50] Page 169, "Salary allowance, etc."

[51] Pages 153, 154, "Revaluation of Property."

average invested capital for the year or period averaged monthly, according to the following rules: [52]

95 (*a*) Add the capital for each of the several months during which no change occurs, and the average capital [ascertained as provided in subdivision (*b*) of this article] for each month in which a change occurs and divide the total by the number of months in the year or period.[53]

96 (*b*) To ascertain the capital for any month in which a change occurs multiply the capital as of the first day of the month by the number of days it remains constant and the capital after each change by the number of days (including the day on which the change occurs) during which it remains constant, add the products, and divide the sum by the number of days in the month.[54]

[52] In this connection it should be noted that the individual may include average profits earned during the taxable year. See Article 69.

[53] Illustration: Assuming that the capital for the first ten months remains constant at $50,000; that in each month thereafter it varies, as shown in note No. 54, the average capital would be computed as follows:

$50,000 × 10 =	$500,000.00
Average for November =	59,000.00
Average for December =	75,483.87
Total.....	$634,483.87

634,483.87 ÷ 12 = $52,873.66, average capital for year.

[54] Illustration: Assuming that the capital on Nov. 1 is $50,000; on Nov. 5 becomes $55,000; on Nov. 15, $60,000 and on Nov. 25, $70,000. The average capital for the month would be derived as follows:

Nov.	1	to	4	(both inclusive)	=	4 days	@	50,000 =	$ 200,000
"	5	"	14	" "	=	10 "	@	55,000 =	550,000
"	15	"	24	" "	=	10 "	@	60,000 =	600,000
"	25	"	30	" "	=	6 "	@	70,000 =	420,000
Totals.....						30.....			$1,770,000

1,770,000 ÷ 30 (days in month) = $59,000 = average capital for month.

Assuming that in the month of December there was only one change,

97 ART. 44. **Items not allowed to be included in invested capital.**—The second paragraph of section 207 of the excess profits law specifies certain items which may not be included in invested capital, namely:

98 (*a*) Stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the excess profits tax; and

99 (*b*) Money or other property borrowed.[55]

100 The term "money or other property borrowed" as used in section 207 and these regulations includes not only cash or other borrowed property which can be identified as such, but current liabilities and temporary indebtedness of all kinds, and any permanent indebtedness upon which the taxpayer is entitled to an interest deduction in computing net income.[56] A corporation which under the income-tax law is allowed to deduct only a part of the entire interest paid upon its indebtedness,[57] may include in its invested capital such a proportion of its permanent indebtedness as the amount of interest upon such indebtedness which the corporation is not allowed to deduct is of the total amount of interest paid upon such indebtedness during the taxable year.[58]

namely, on Dec. 15, an increase of $10,000, the average capital would be $75,483.87, derived as follows:

Dec. 1 to 14 (both inclusive)	= 14 days	@ 70,000	=	$ 980,000
" 15 " 31 " "	= 17 "	@ 80,000	=	1,360,000
Totals	31			$2,340,000

2,340,000 ÷ 31 = $75,483.87 = average capital for month.

[55] Page 128, "Exclusions from Invested Capital."

[56] See Example of Computing Invested Capital, page 157.

[57] Limitation of interest deductible, pages 202 and 203.

[58] Illustration: Assuming that a real estate corporation has a capital stock of $10,000; that it owns a building on which there is a mortgage of $200,000, bearing interest at 6 per cent, amounting to $12,000 per annum. The deductible interest, by limitation of law, would be $6,600, as follows:

Capital Stock	$ 10,000.00
½ of interest bearing indebtedness (½ of $200,000)	100,000.00
Total	$110,000.00

101 ART. 45. **When income from tax-free securities consists partly of trading profits and partly of interest, dividends, etc.**—Whenever income consists partly of gains or profits subject to the excess profits tax arising from trading in stocks, bonds, etc., the dividends or interest on which are not subject to such tax, and partly of such dividends or interest, then, subject to the limitations as to borrowed money, there shall be included in the invested capital an amount which bears the same ratio to the total amount invested in such stocks or bonds as the amount of such gains or profits bears to the total amount of such income.[59]

102 ART. 46. **Treatment of stock of foreign corporations when held by domestic corporations or partnerships or by citizens or residents of the United States.**—In the case of **domestic corporations or partnerships** and of **citizens** or **residents** of the United States holding stock in a foreign corporation part of whose net income is subject to the income tax, there shall be included in invested capital such proportion of the

Interest deductible @ 6 per cent.....	$ 6,600.00
Interest not deductible.....	5,400.00
Total interest paid.....	$ 12,000.00

The proportion of indebtedness that may be stated as invested capital would be computed as follows:

Interest not deductible : total interest paid : : ? : permanent indebtedness =

5,400 : 12,000 : : ? : 200,000 =

(5,400 × 200,000) ÷ 12,000 = $90,000, which may be added to invested capital.

[59] Illustration: Assuming that a dealer in securities had during the taxable year, an average investment, in tax-exempt stocks and bonds, of $150,000: that during said period he had earned from trading therein the sum of $10,000: that the interest and dividends received thereon amounted to $5,000; the proportion of invested capital would then be stated as follows:

Trading profit : total income : : ? : Investment =

10,000 : 15,000 : : ? : 150,000 =

(10,000 × 150,000) ÷ 15,000 = $100,000

If the dealer had borrowed money on such securities the average amount borrowed would be deducted from the average total investment.

value of the stock in such foreign corporation as the net income of such foreign corporation from sources outside the United States is of its entire net income.[60]

103 ART. 47. **Construction of terms "tangible property" and "intangible property."**—The term "other intangible property" as used in section 207 will be construed to mean property of a character similar to good will, trade-marks, and the other specific kinds of property enumerated in the same clause. With respect to property not clearly of such a character, rulings will be issued as occasion may demand to indicate whether it shall be regarded as tangible or intangible.

104 The following classes of property, when paid in for stock or shares in a corporation or partnership, will be regarded as tangible property so paid in:[61]

(*a*) Stocks.
(*b*) Bonds.
(*c*) Bills and accounts receivable.
(*d*) Notes and other evidences of indebtedness.
(*e*) Leaseholds.

But when a corporation pays for intangible property by the issuance of its own stock or bonds, this will not be regarded as being a payment bona fide made in cash or tangible property within the meaning of section 207.

105 ART. 48. **Invested capital of foreign corporations or partnerships or nonresident alien individuals.**—When used with reference to a **foreign corporation or partnership** or a **nonresident alien individual**, the term "invested capital" means that proportion of the entire invested capital as

[60] Illustration: Assuming that a domestic corporation holds stock in a foreign corporation of the value of $27,000; that the foreign corporation had an income subject to income taxes of $40,000 and income from foreign sources of $50,000 not subject to income taxes; the part of the value of such stock that may be stated as invested capital would be $15,000, computed by proportion as follows:

Foreign Income: Total Income :: ? : Value of Stock =
50,000 : 90,000 :: ? : $27,000 =
(50,000 × 27,000) ÷ 90,000 = $15,000.

[61] Page 168, "Tangible and Intangible Property Defined."

defined and limited by these regulations which the net income from sources within the United States is of the entire net income.[62]

106 ART. 49. **Reorganization on or after January 2, 1913.**—A trade or business carried on by a corporation, partnership, or individual, which has been formally organized or reorganized on or after January 2, 1913, but which is substantially a continuation of a trade or business carried on prior to that date, shall, for the purposes of the excess profits tax, be deemed to have been in existence prior to that date and the invested capital of its predecessor prior to that date shall be deemed to have been its invested capital. This article relates to the prewar period and does not apply to the invested capital for the taxable year.[63]

107 ART. 50. **Reorganization after March 3, 1917.**—In case of the reorganization, consolidation, or change of ownership of a trade or business after March 3, 1917, if an interest or control in such trade or business of 50 per cent or more remains in control of the same persons, corporations, associations, partnerships, or any of them, then in ascertaining the invested capital of the trade or business no asset transferred or received from the prior trade or business shall be allowed a greater value than would have been allowed under these regulations in computing the invested capital of such prior trade or business if such asset had not been so transferred or received, unless such asset was paid for specifically as such, in cash or tangible property, and then not to exceed the actual cash or actual cash value of the tangible property paid therefor at the time of such payment.[64]

108 ART. 51. **Invested capital for prewar period.**—The in-

[62] Illustration: A foreign corporation having a total invested capital, as limited by law, of $100,000, a net income from sources within the U. S. of $15,000, and a total net income from all sources of $25,000, would have an invested capital for purposes of computing excess profits taxes of $60,000, computed by proportion as follows:

15,000 : 25,000 : : ? : 100,000 =

(15,000 × 100,000) ÷ 25,000 = $60,000.

[63] Page 136, "Reorganized or New Corporation."

[64] Page 135 "Partial Change of Ownership."

vested capital for the prewar period shall, in general, be determined in the same manner as for the taxable year, except that the valuation as of January 1, 1914, shall not apply to tangible property paid in for stock or shares.[65]

109 ART. 52. **Scope of section 210.**—Section 210 provides for exceptional cases in which the invested capital can not be satisfactorily determined. In such cases the taxpayer may submit to the Commissioner of Internal Revenue evidence in support of a claim for assessment under the provisions of section 210.[66] (See articles 18 and 24.) Such exceptional cases may consist, among others, of the following:

110 (1) Where, through defective accounting or the lack of adequate data, it is impossible accurately to compute invested capital.

111 (2) Where upon application by a foreign taxpayer the Secretary of the Treasury finds that the expense of securing the data necessary for the computation of the invested capital would be unreasonable in view of the amount of tax involved, or that it is impracticable to determine either the "entire invested capital" or the "entire net income."

112 (3) Long-established business concerns which by reason of ultra-conservative accounting or the form and manner of their organization would, through the operation of section 207, be placed at a serious disadvantage in competing with representative concerns in a like or similar trade or business.[67]

113 (4) Where the invested capital is seriously disproportionate to the taxable income. Such cases may arise through:

[65] Tangible property, for purposes of invested capital for the prewar period, need not be valued as prescribed by article 55.

[66] Law, page 257, "Where invested capital is not determinable."

The return (Form 1103) should be filled in so far as the corporation can answer the questions contained therein and there should be attached a statement explaining why the return is inapplicable or why it cannot be fully answered. Paragraphs 1, 2, 3 and 4 following article 52 state circumstances under which invested capital may not be determinable or not fairly determinable."

[67] See "Limitation of Value of Property as at Jan. 1, 1914," pages 173–147.

114 (*a*) The realization in one year of the earnings of capital unproductively invested through a period of years or of the fruits of activities antedating the taxable year; or,

115 (*b*) Inability to recognize or properly allow for amortization, obsolescence, or exceptional depreciation due to the present war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war.[68]

INVESTED CAPITAL—CORPORATIONS AND PARTNERSHIPS

116 ART. 53. **Rule for computing invested capital.**—In computing invested capital, every corporation or partnership paying taxes at the graduated rates prescribed in section 201 (see art. 16), shall add together its **paid in capital** and its **paid in or earned surplus and undivided profits** (under whatever name the same may be called) as shown by its books at the beginning of the taxable year.[69] The total thus obtained shall be adjusted for any asset or item which it covers that is not carried on the books at the valuation prescribed by law or by these regulations.[70] When necessary, adjustment (addition or subtraction) shall be made in respect of the following:

ADJUSTMENTS

117 1. Stock or shares issued in the purchase of intangible property prior to March 3, 1917, which can not be included in an amount exceeding (*a*) 20 per cent of the par value of the total stock or shares outstanding on that date, (*b*) the actual value of such intangible property at the date acquired, or (*c*) the par value of the stock or shares issued in payment therefor, whichever is the lowest. (See arts. 57 and 58.) [71]

118 2. Stock or shares issued for a mixed aggregate of tangible

[68] Page 190 "Munitions Works—War Materials."

[69] See Reserve Accounts and Reserve Funds, page 138.

[70] See "Invested Capital, Books of Account," page 130.

[71] See "Good Will, Trade-marks, Franchises," page 138.

property, patents and copyrights, and good will or other intangible property. (See art. 59.)

119 3. Stock or shares issued for patents and copyrights, valued at (*a*) their actual cash value at the time of payment, or (*b*) the par value of the stock or shares issued therefor, whichever is lower. (See art. 56.)

120 4. Stock or shares issued for tangible property prior to January 1, 1914, valued at (*a*) the actual cash value of such property on January 1, 1914, or (*b*) the par value of the stock, whichever is lower. (See art. 55.)

121 5. Stock originally issued for property and subsequently returned to the corporation as a gift, etc. (See art. 54.)

122 6. Add any proportion of its permanent indebtedness which may be included under article 44.

123 7. Add value of tangible property paid in for stock or shares in excess of the par value of such shares, when authorized by article 63.

124 8. Add amounts expended in the past for (*a*) the acquisition of tangible property or (*b*) specifically for good will and other similar intangible property, when authorized by article 64.

125 9. For the valuation of assets acquired in reorganizations, etc., (*a*) effected after March 3, 1917, see article 50; (*b*) as to the prewar period, see articles 49 and 51.

126 10. Deduct amounts representing appreciation excluded by article 42.

127 11. Make any additional deductions required by reason of insufficient allowances in the accounts of the taxpayer for depletion, depreciation, and obsolescence. (See art. 42.)

128 Whenever any corrections are made in respect of the capital stock and surplus, corresponding corrections must be made in the respective asset items in the balance sheet of the taxpayer.

129 After making any adjustments required under paragraphs 1 to 11 above, the adjusted total of the capital and surplus account will represent the invested capital at the beginning of the taxable year, except that in any case where the admissible assets (and these include all assets when valued in accordance with these regulations, except stocks, bonds—

other than obligations of the United States—the income of which is not subject to excess profits tax) are less than the amount of such adjusted total, then the invested capital must be further reduced to an amount equal to the sum of the admissible assets. Tax-free securities and stock in foreign corporations may be included as admissible assets *to the extent* authorized in articles 45 and 46.

130 If there has been any change made during the taxable year in the amount of the invested capital, the monthly average shall be taken (see art. 43), but in no case may the invested capital include any surplus or undivided profits earned during the taxable year.

131 With respect to the taxable year 1917, every such corporation and partnership will be required to submit a balance sheet as at the first day of the taxable year and also a balance sheet as at the close of the taxable year. Thereafter every such corporation and partnership will be required to submit a balance sheet as at the close of each taxable year. Balance sheets should be made in accordance with the books of the taxpayer and changes in respect of any items therein made pursuant to these regulations should be explained in a separate statement attached to the balance sheet to which it relates.

132 ART. 54. **Stock returned to corporation.**—For the purpose of computing invested capital, in cases where the stock of a corporation is issued or exchanged for property (tangible or intangible), the following rule will apply:

133 When any of such stock is returned to the corporation as a gift or for a consideration substantially less than its par value, the stock so returned shall not be treated as a part of the stock issued or exchanged for such property. The proceeds derived in cash or its equivalent from the resale of the stock so returned shall, however, be included in the invested capital if retained and employed in the business.[72]

[72] The qualification of invested capital appears to apply only to stock issued or exchanged for property (tangible and intangible) and not where stock is issued for cash. The writer reached the same conclusion (page 166) both with respect to stock paid for by property and that paid for by cash, and he believes the law justifies no other interpretation. Inasmuch as

134 ART. 55. **Valuation of tangible property paid in for stock or shares.**—Tangible property paid in for stock or shares prior to January 1, 1914, must be valued at either (*a*) the actual cash value of such property on January 1, 1914, or (*b*) the par value of the stock or shares specifically issued therefor, whichever is lower. This is one of the few cases in which the law permits allowance to be made for appreciation, and here no appreciation can be recognized unless the original stock or shares were *specifically* issued in exchange for such tangible property.[73]

135 Tangible property paid in for stock or shares on or after January 1, 1914, will be taken at the actual cash value of such property at the time of payment, irrespective of the par value of the stock or shares.[74]

136 ART. 56. **Patents and copyrights.**—Patents and copyrights paid in for stock or shares must be valued at either (*a*) the actual cash value at the time of payment or (*b*) the par value of the stock or shares issued therefor, whichever is lower.[75]

invested capital is, by law, defined as cash paid in or actual cash value of property paid in, with limitations in case of intangible property, regardless of who holds the stock, the invested capital exists and the corporation should be entitled to credit for the full amount of capital actually paid in, subject only to limitations of law as to intangible property.

[73] Where any appreciation is allowed under (*a*) or (*b*) is not clear to the writer except, perhaps, where stock was issued in exchange for property at an amount in excess of the actual value of the property at the time of issuance, and prior to Jan. 1, 1914. Where property was taken over at the actual value thereof, subsequent appreciation in the value does not increase the invested capital. See article 63, in re paid-in surplus.

[74] This provision permits the inclusion, as invested capital, of the full cash value of property received by a corporation in payment of its capital stock issued on and after January 1, 1914, *regardless* of the par value of such stock. For example, if a corporation on Jan. 1, 1914, exchanges stock of the par value of $30,000 for a building of the cash value of $50,000, the invested capital may be stated as $50,000. In that case the difference of $20,000 is surplus which, by provision of law, constitutes invested capital. This provision is applicable only to tangible property or property construed by rulings of the Department to be the equivalent thereof.

[75] Page 129 "Patents, Copyrights," etc.

137 ART. 57. **Valuation of intangible property.**—If good will, trade-marks, trade brands, franchises of a corporation or partnership, or other intangible property has been purchased with stock or shares issued prior to March 3, 1917, the amount that may be included in invested capital must not exceed (*a*) 20 per cent of the par value of the total stock or shares outstanding on that date, nor (*b*) the actual value of the asset at the date acquired, nor (*c*) the par value of the stock issued in payment for the asset.[76]

138 ART. 58. **Application of 20 per cent limitation upon intangible property.**—The 20 per cent limitation upon intangible property purchased prior to March 3, 1917, for or with stock or shares of the corporation or partnership, alplies not to each item or class of intangible property separately, but to the aggregate amount of all such property so purchased. Such intangible property may be included in the invested capital only up to an amount not exceeding 20 per cent of the total stock or shares of the corporation or partnership on March 3, 1917, even though the aggregate amount of such intangible property be greater in value than such 20 per cent of the par value of the total stock or shares.[77]

139 Intangible property bona fide purchased prior to March 3, 1917, with stock having no par value may be included in invested capital at a value not exceeding the actual cash value of such intangible property at the time of the purchase and in an amount not exceeding 20 per cent of the total shares of stock outstanding on March 3, 1917, measured by their value as at the date or dates of issue.[78]

[76] Page 138 "Good Will, Trade-marks," etc.

[77] For example, a corporation with an outstanding capital stock on March 3, 1917, of $200,000, which had previously acquired, for stock, good will of the value of $25,000, trade-marks and trade brands of the respective values of $50,000 and $60,000, could include as invested capital on account of the aggregate value of the intangible property, only 20 per cent of the capital stock, namely, $40,000. See example, page 163.

[78] The measure of value of such stock (without par value) would be based upon the amount received by the corporation for the original issue of the stock, or the value of property for which the stock was issued.

140 ART. 59. **Rules to govern cases where shares or securities are issued for mixed aggregate of tangible and intangible property.**—Where stock or shares (or stock or shares and bonds or other obligations) have, prior to March 3, 1917, been issued for a mixed aggregate of—

(*a*) Tangible property,

(*b*) Patents and copyrights, and

(*c*) Good will or other intangible property,

the following rules will govern:

141 (1) In the absence of satisfactory evidence to the contrary, it will be presumed in the case of a corporation, that its stock was issued for the following purposes in the order named:[79]

(*a*) Good will or other intangible property,

(*b*) Patents and copyrights, and

(*c*) Tangible property.

142 (2) Upon the production by the taxpayer of evidence satisfactory to the Commissioner of Internal Revenue as to the actual values at the date of acquisition of (*a*) the tangible property and (*b*) the patents and copyrights, the sum of these two items may be applied against the total par value of the securities issued and the remainder will then be deemed to represent the par value of the securities issued for the good will or other intangible property.[80]

143 (3) Cases where mixed aggregates of tangible and intangible property have been paid in for stock and bonds shall, if the Secretary of the Treasury is unable to determine satisfactorily the respective values of the several classes of property at the time of payment, be treated as coming un-

[79] To reserve this order it is necessary only to prove that the tangible property, patents, etc., have actual value. The purpose of the provision is to preclude the statement of tangible properties where they actually were intangible. The burden of proof is placed upon the taxpayer.

[80] In other words, the difference between the par value of stock issued and the sum of the actual values of the tangible property, patents and copyrights, represents the value of good will or the intangible property. It should be noted that the term "securities issued" is used. If the mixed tangible and intangible property was paid for by stocks and bonds the aggregate total par value of both stocks and bonds would be used in the apportionment.

der articles 18 and 24 and the tax shall be assessed accordingly.

144 ART. 60. **Valuation of intangible assets purchased.**—Good will and other similar intangible assets purchased with cash or tangible property must be taken at a value not in excess of the cash or actual cash value of the tangible property specifically paid therefor.

145 ART. 61. **Surplus or undivided profits earned during any year excluded in computing invested capital for such year.**—Profits earned during any taxable year or prewar year shall not be included in the computation of the invested capital for such year, even though set up as "surplus" upon the books or distributed in the form of stock dividends.[81]

146 ART. 62. **Scope of phrase "surplus and undivided profits."**—Clause (3) of subdivision (*a*) of section 207 authorizes the inclusion in invested capital of earned surplus and undivided profits used or employed in the business. Inasmuch as section 201 provides that all the income of a corporation or partnership shall be deemed to be received from its trade or business, all the surplus and undivided profits of a corporation or partnership (exclusive of undivided profits earned during the year), from whatever source derived, will, unless invested in stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the excess profits tax, be deemed to be used or employed in the business and may be included in the invested capital.[82]

147 ART. 63. **When tangible property may be included in surplus.**—Where it can be shown by evidence satisfactory to the Commissioner of Internal Revenue that tangible property has been conveyed to a corporation or partnership by gift or at a value, accurately ascertainable or definitely known as at the date of conveyance, clearly and substantially in excess of the cash or the par value of the stock or shares paid therefor, then the amount of the excess shall be deemed to be paid in surplus. The adopted value shall not cover mineral deposits or other properties discovered or

[81] How to compute surplus, see page 154.

[82] See examples, Computing Invested Capital, pages 155 to 165.

developed after the date of conveyance, but shall be confined to the value accurately ascertainable or definitely known at that time.[83]

148 Evidence tending to support a claim for a paid-in surplus under these circumstances must be as of the date of conveyance, and may consist, among other things, of (1) an appraisal of the property by disinterested authorities, (2) the assessed value in the case of real estate, and (3) the market price in excess of the par value of the stock or shares.

149 ART. 64. **Reconstruction of surplus and undivided profits accounts.**—Where through failure to provide for depletion, depreciation, obsolescence, or other expenses or losses, or where for any other cause or reason the books of account of the taxpayer do not show the true paid-in or earned surplus and undivided profits, in the computation of invested capital such adjustments shall be made as are necessary to arrive at a statement of the correct amount.[84]

150 Where a taxpayer claims additions to the capital account, the books of account will be presumed to show the true facts and the burden of proof will rest upon the taxpayer.[85] Such additions will be accepted only to the extent and under the conditions stated below:

151 (1) Amounts which have been expended in the past for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper reduction for depreciation or obsolescence) be added to the surplus account in computing invested capital when such assets are still owned and in active use by the taxpayer during the taxable year. Special tools, patterns, and similar assets shall not be assigned

[83] This provision will be applicable in a case where a corporation was formed with a nominal capital stock, not representative of the actual value of property conveyed to the corporation in exchange for such stock. See Illustration, pages 152 and 153.

[84] See "Plant & Machinery," "Furniture & Fixtures," "Land" and "Buildings," pages 160, 161, 162 and 163.

[85] See "Invested Capital, Books of Account," page 130.

any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.[86]

152 (2) Amounts expended in the past for good will, trademarks, trade brands, franchises, and other intangible assets of a like character, are controlled by the language of the statute which provides that such assets "shall be included in invested capital if the corporation or partnership made payment bona fide therefor specifically as such in cash, or tangible property." The Commissioner of Internal Revenue will recognize additions to invested capital on account of intangible assets only if such assets have been explicitly paid for in the manner prescribed by the statute. Where expenditures have been made for the general development of intangible assets, and charged as current expense, no readjustment thereof will be allowed.[87]

153 (3) Amounts under (1) and (2) above, expended on or after March 1, 1913, will, in the case of a corporation, be limited strictly to items which have not been deducted in computing taxable income upon its income tax return. Whenever a corporation has claimed and the department has allowed a deduction in respect to its income tax, the item upon which the deduction is based shall not be restored to the surplus account nor included in the invested capital.[88]

154 (4) The taxpayer shall in his return to the Commissioner of Internal Revenue make a statement of the proposed additions, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and

[86] Depreciation written off prior to incidence of tax, page 161.

[87] It would appear, by innuendo, that where expenses have been capitalized, for example, advertising, such capitalized expenses constitute invested capital.

[88] See "Adjusting Excess Depreciation," page 195.

the method followed in distinguishing between capital outlays and current expenses.[89]

155 (5) The taxpayer shall also show that adequate provision has been made for the depletion, depreciation, or obsolescence of such of the assets so acquired as are, under the rulings of the department, subject to recognized depreciation.[90]

156 ART. 65. **Invested capital of insurance companies.**—(*a*) The invested capital of a **mutual insurance company** will be deemed to consist of the sum of (1) any surplus or contingent reserves maintained for the general use of the business, plus (2) any legal reserves the net additions to which are included in the net income subject to the tax—subject to the restrictive provisions of article 44 requiring the exclusion of tax-free assets other than obligations of the United States.

157 (*b*) The invested capital of a **stock insurance company** will be deemed to consist of its capital stock, paid-in or earned surplus and undivided profits (subject to the same restrictive provision of art. 44), computed in accordance with the provisions of article 53.

INVESTED CAPITAL—INDIVIDUALS

158 ART. 66. **Items included in invested capital.**—Subject to the limitations stated in these regulations the invested capital of an **individual** is measured by the total of three items:[91]

(1) Actual cash paid into the trade or business,

(2) Tangible property paid into the trade or business,

(3) Patents and copyrights, and good will, trade-marks, trade brands, franchises, and other intangible property. (See art. 68.)

159 ART. 67. **Valuation of tangible property.**—Subject to the requirements of article 42 as to allowance for depletion,

[89] The "proposed additions" on the basis of which the return is made, should accompany the return.

[90] Productivity of property is an important consideration. Page 162.

[91] See "Invested Capital of Individual," pages 129 and 154. Accumulated earnings employed in a business constitute invested capital.

depreciation, and obsolescence, valuation of tangible property will be as follows:[92]

160 In the case of tangible property purchased with cash, the valuation will be based upon the cost (estimated if not known) in cash at the time purchased.

161 In the case of tangible property paid in as such prior to January 1, 1914, the valuation will be based upon its actual cash value as of that date. Adequate evidence of such value must be furnished by the taxpayer.

162 In the case of tangible property paid in on or after January 1, 1914, the valuation will be based upon its actual cash value at the time of payment.

163 It will be presumed that the tangible assets employed in the trade or business have been acquired with cash which has been either paid in directly or derived from earnings of the trade or business; but the taxpayer will be entitled to show that such assets were paid in as tangible property.

164 ART. 68. **Valuation of intangible property.**—Patents and copyrights, and good will, trade-marks, trade brands, franchises, and other similar intangible assets may be included in invested capital at a value not to exceed the actual cash paid therefor or the actual cash value at the time of payment of the tangible property paid therefor, but only if bona fide payment was made therefor specifically as such in cash or tangible property.

165 ART. 69. **Profits earned during taxable year may be included.**—The restriction in respect of undivided profits earned during the taxable year which is imposed upon corporations and partnerships does not apply to individuals, and therefore, unless otherwise shown, the profits of the taxable year remaining in the trade or business will be deemed to have arisen ratably throughout the year, and the capital at the beginning of the year may be increased by the total amount of such profits remaining in the trade or business averaged monthly over the year.[93]

166 ART. 70. **Rule for computing invested capital.**—Where an individual keeps books of account his invested capital will

[92] See "Revaluation of Property," page 153.

[93] Use same method as outlined in footnote No. 95.

be found in his capital account (under whatever name it may be called) after making therein any adjustments or corrections required by these regulations, provided that the assets other than those not allowed to be included equal or exceed the amount of such capital account. Otherwise the invested capital shall be the amount of such assets.[94]

167 Where an individual does not keep books of account he should prepare and preserve a statement as at the beginning of the taxable year and as at the end of the taxable year, showing in full all his assets valued in accordance with these regulations, and all his liabilities. The excess of such assets over such liabilities at the beginning of the year and again at the end of the year will constitute the invested capital of the individual on those dates, respectively, provided, that in each case the assets other than those not allowed to be included equal or exceed the amount of such excess. Otherwise the invested capital shall be the amount of such assets. The amount of the difference between the capital thus shown as at the beginning of the year and at the end of the year will, in the absence of evidence to the contrary, be deemed to have arisen ratably throughout the year, and the capital at the beginning of the year will be increased or decreased, as the case may be, by such amount averaged monthly over the year.[95]

[94] The capital account as shown by the books of account is the excess of the total amount of assets over and above the total amount of liabilities. Make any necessary adjustments or corrections of the capital account as required by the regulations. List the assets that by provision of law and regulations, constitute invested capital. If the total amount of such assets equals or exceeds the amount of capital account, the capital account will be the invested capital, and if the total of such assets is less than the capital account, then the total amount of such assets will be the invested capital. Add to or deduct from the invested capital the average increase or decrease of capital for the taxable year, determined as outlined in the following note.

[95] Prepare statements as outlined in the foregoing note (No. 94) as at beginning of year and end of the year and apply the rules therein laid down in determining the invested capital. If the statement as at the end of the year shows an increase over that of the beginning, such increase represents a net profit assumed to have been ratably earned during the year. For example, if the assets at the end of the year amount to $100,000 and at the

168 If an individual is engaged in more than one trade or business having invested capital, then his invested capital for the purposes of computing the deduction and applying the rates of taxation will be determined by taking the total invested capital of all such trades or businesses.[96]

169 The terms "assets" and "liabilities" as used in this article relate only to the assets or liabilities of the trade or business.

Nominal Capital

170 Art. 71. **Application of section 209.**—Section 209 (see art. 15) applies primarily to occupations, professions, trades, and businesses engaged principally in rendering personal service in which the employment of capital is not

beginning of the year $70,000, it will be assumed that there had been earned an average of $2,500 per month and the average invested capital will be computed as follows:

Invested Capital in:

January	$70,000.00
February	72,500.00
March	75,000.00
April	77,500.00
May	80,000.00
June	82,500.00
July	85,000.00
August	87,500.00
September	90,000.00
October	92,500.00
November	95,000.00
December	97,500.00
(Dec. 31, $100,000)	
12)	1,005,000.00
	$83,750.00 = Average invested capital.

Under the language of the regulations, the capital at the beginning of the year would be increased by the average monthly profit, $2,500, or $72,500 at the end of the year, but that, obviously, is not the average invested capital because the capital is compounded monthly.

[96] See illustration, article 35.

necessary and the earnings of which are to be ascribed primarily to the activities of the owners.[97]

171 In determining whether a trade or business is taxable under article 15 no weight will be given to the fact that it is carried on by means of personal service unless the principal owners are regularly engaged in the active conduct of the trade or business.[98]

172 ART. 72. **Application of section 209 not to be affected by mere size of capital, form of organization, etc.**—Business concerns which render professional or personal service and are of the class normally taxable under article 15 shall not be taken out of that class merely because of the size of the capital if the employment of such capital is necessitated by delay and irregularity in the receipt of fees, etc., or if such capital is wholly or mainly used as a fund from which to advance salaries, wages, etc., or to provide office furniture, accommodations, and equipment, nor because of the form of organization, whether corporation or partnership, nor in the case of a partnership because of the number of partners.[99]

173 ART. 73. **Agents and brokers.**—Agents and brokers requiring and using no capital or merely a nominal capital in their business are taxable under article 15, but commission houses regularly employing a substantial amount of capital, whether to lend to principals or to carry goods on their own account, are not deemed to be agents or brokers and are taxable under the provisions of article 16.

174 ART. 74. **Meaning of "nominal capital"; businesses which will not be deemed to have nominal capital.**—The term "nominal capital" as used in section 209 means in general a small or negligible capital whose use in a particular trade or business is incidental. The following will

[97] See "Nominal Capital," page 133.

[98] Only those actually engaged in the conduct of their trade or business, having a nominal or not more than a nominal capital, can avail themselves of the 8 per cent rate; where the owners are not active the rates applicable to invested capital will be applicable.

[99] The terms of this article are limited to concerns rendering professional or personal services.

not be construed as businesses having a nominal capital for purposes of excess profits tax:

175 (*a*) A business which because of conditions arising from the war or exceptional opportunities for profits earns a disproportionately high rate of profit during the taxable year, if it belongs to a class which necessarily and customarily requires capital for its operation. In the determination of doubtful cases stress will be laid upon the normal relation of net income to capital during prewar years; [100]

176 (*b*) Corporations which, although their capitalization is nominal, employ a substantial amount of capital in their business; [101]

177 (*c*) A business having a substantial capital, but whose invested capital within the meaning of section 207 is reduced to a nominal amount by the operation of the restrictive clauses of that section, e. g., where the capital, consisting originally of a small amount of cash paid in, has since appreciated in value, or where the capital is largely covered by indebtedness or consists principally of tax-free securities or of intangible assets built up or developed by expenditures which have been regularly deducted as items of current expense.

RETURNS

178 ART. 75. **When a return of information as to the invested capital and net income for the prewar period will not be required.**—For the purposes of the excess profits tax, a return of information with respect to the invested capital and net income for the prewar period will not be required of a corporation, partnership, or individual in the following cases:

179 (1) If the taxpayer accepts the minimum percentage, viz.,

[100] If the character of a business has changed since the prewar period, mention thereof should be made. As to the significance of "normal relation of net income to capital during prewar years," this must be determined upon the peculiar facts of each case.

[101] See "Application of Law to real and nominal capital," pages 152 and 153.

7 per cent, as the percentage to be used in computing the deduction under article 21; or [102]

180 (2) If the trade or business is taxable only at the 8 per cent rate under article 15.

181 This article must not be construed as not requiring a return of information as to all facts which may be necessary for the ascertainment of the capital and income for the taxable year whenever such a return is required by the Commissioner of Internal Revenue.

182 ART. 76. **A married woman may make separate return.**—A married woman who is a sole trader or is entitled to any taxable income to her sole and separate use may, for purposes of the excess profits tax, make a separate return in the same manner as any other individual.

183 ART. 77. **When affiliated corporations must furnish information as to intercorporate relations.**—For the purpose of the excess profits tax every corporation will describe in its return all its intercorporate relationships with other corporations with which it is affiliated, and will furnish such information in relation thereto as will enable the Commissioner of Internal Revenue to compute the amount of the tax properly due from each corporation on the basis of an equitable and lawful accounting.

184 For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is owned by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus effecting an artificial distribution of profits, or (b) in any way so arranges its financial relationships with another corporation as to assign to it a disproportionate share of net income or invested capital.

[102] See "Return of Prewar Period," page 172.

185 ART. 78. **When affiliated corporations may be required to make consolidated return.**[103]—Whenever necessary to more equitably determine the invested capital or taxable income, the Commissioner of Internal Revenue may require corporations classed as affiliated under article 77 to furnish a consolidated return of net income and invested capital. Where such consolidated return is required it may be made by any one or more of such corporations or by all of them acting jointly; but if such affiliated corporations, when requested to file such consolidated return, neglect or refuse to do so, the Commissioner of Internal Revenue may cause an examination of the books of all such corporations to be made and a consolidated statement to be made from such examination. In cases where consolidated returns are accepted, the total tax will be computed in the first instance as a unit upon the basis of the consolidated return and will be assessed upon the respective affiliated corporations in such proportions as may be agreed among them. If no such agreement is made the tax will be assessed upon each such corporation in accordance with the net income and invested capital properly assignable to it.

ASSESSMENT AND COLLECTION

186 ART. 79. **Assessment and collection governed by income tax regulations.**—All excess profits taxes to which any taxpayer is subject shall be assessed and collected at the same time and in the same manner as provided with respect to

[103] "For the purpose of this regulation two or more corporations will be deemed to be affiliated (1) when one such corporation owns directly or controls through closely affiliated interests or by a nominee or nominees, all or substantially all of the stock of the other or others, or when substantially all of the stock of two or more corporations is owned by the same individual or partnership, and both or all of such corporations are engaged in the same or a closely related business; or (2) when one such corporation (a) buys from or sells to another products or services at prices above or below the current market, thus affecting an artificial distribution of profits; or (b) in any way so arranges its financial relationships with another corporation as to assign to it a disproportionate share of net income or invested capital." Extract from T. D. 2662.

income taxes in the income tax regulations in so far as the same are applicable.

DANIEL C. ROPER,
Commissioner of Internal Revenue.

Approved:
W. G. MCADOO,
Secretary of the Treasury.

INDEX

Paragraph

Abatement claim on Form 47 when making return in cases of prewar income being undeterminable satisfactorily; low or none..... 50
Accounting:
Defective; bearing on invested capital..... 110
Adjustment of, in connection with surplus.....149, 155
Individuals—
Books kept..... 166
Books not kept..... 167
Ultraconservatism in past years..... 112
Accounts payable in relation to invested capital..... 99
Accounts receivable construed to be tangible property..... 104
Additions on annual balance sheet in computing "invested capital". 117
Adjustments required on annual balance sheet of corporations and partnerships..... 117
Invested capital determined on basis of balance sheet as adjusted..... 129
Affiliated corporations; returns, etc.....183, 185
Agents and brokers versus commission houses and merchants..... 173
Agents, nominal capital..... 173
Alaska..... 3, 4
Amortization in relation to invested capital..... 115
Annual balance sheet. (*See* "Balance sheet.")
Appreciation in value of assets in connection with invested capital.. 93, 177
Correction of annual balance sheet..... 126
Tangible property acquired prior to January 1, 1914..... 134
Assessment and collection of tax..... 186
Parent, subsidiary, and affiliated corporations.....183, 185
Assets and liabilities in connection with invested capital of individuals..... 169
Averaging invested capital; method of..... 94
Balance sheet required annually of corporations and partnerships.. 131
Corrections necessary..... 117
Invested capital determined on basis of balance sheet as corrected..... 129
Bequest, value of is exempt from tax..... 58
Bills payable in connection with invested capital..... 99
Bills receivable construed to be tangible property..... 104

Paragraph

Bond may be required when claim for abatement is made on making return in cases of prewar income being undeterminable satisfactorily, low or none... 50
Bonded indebtedness versus capital; bearing on invested capital.. 177
Bonds in relation to invested capital....98, 101, 177
Intangible property paid for in bonds not considered as paid for in cash or tangible property.... 104
Surplus or undivided profits invested in tax-free bonds.... 146
Tangible and intangible property; bonds issued for mixed aggregates of.... 140
Tangible property; bonds construed to be.... 104
Books; defective or poorly kept; bearing on invested capital.... 110
Adjustment of in connection with surplus.... 149
Books of account; individuals.... 166
Not kept.... 167
Borrowed money and other property in relation to invested capital.. 99
Brokers; nominal capital.... 173
Business defined. (*See* "Trade or business.")
Invested capital: Business which will be deemed not to have nominal capital.... 174
Nominal capital: Businesses involving personal service.... 170
Capital invested. (*See* "Invested capital.")
No invested capital. (*See* "Nominal capital.")
Nominal capital. (*See* "Nominal capital.")
Capital of considerable amount does not preclude nominal capital. 172
Capital versus "invested capital"....112, 172, 174
Capitalization, small or nominal; relation to invested capital.... 174
Change of ownership since Jan. 2, 1913.... 42, 106
Change of ownership since Mar. 3, 1917; invested capital.... 107
Citizens and residents. (*See* "Individuals.")
Claim for abatement when making return in cases of prewar income being undeterminable satisfactorily; low or none.... 50
Class A income.... 22
Rate of tax.... 26
Class B income.... 23
Rate of tax.... 27
Classification of net income subject to tax.... 21
Commission merchants versus agents and brokers in connection with nominal and invested capital.... 173
Compensation. (*See* "Salaries.")
Computation of deduction (*see also* "Deduction: computation of") 38
Computation of invested capital; rule (*see also* "Invested capital") 116

Paragraph

Computation of tax. (*See* "Tax: computation of.")
Consolidated return. (*See* "Returns.")
Consolidations since Jan. 2, 1913 ..... 42, 106
Consolidations since Mar. 3, 1917; invested capital 107
Constructive capital for application of rates 33
Copartnerships. (*See* "Partnerships.")
Copyrights paid in for stock or shares: valuation of 136
  Correction of annual balance sheet 118, 119
  Mixed tangibles, intangibles, patents, and copyrights 140
Corporations defined 2
Corporations:
  Affiliated corporations 183, 185
  Balance sheet as of last day of taxable year to be submitted .. 131
    Corrections required 117
    Invested capital determined on basis of balance sheet as corrected 129
  Business defined 7
    All trades or businesses considered as one 24
  Consolidated since January 2, 1913 ..... 42, 106
  Consolidations since March 3, 1917 107
  Deduction, computation of 38
  Exempt corporations 18
  Fiscal year 5
    Invested capital not satisfactorily determinable 55
    Less than 12 months' period 37
    Partially within 1916 36
  Foreign, return and tax liability 12
  Holding companies 183, 185
  Income taxable, classification 21
  Invested capital 93
    Rule for computing (*see also* "Invested capital") 116
  Investment of surplus in securities, tax-free and otherwise 146
  Net income—
    Prewar period 65
    Taxable year 64
  Nominal capital. (*See* "Nominal capital.")
  Parent corporations 183, 185
  Prewar income—
    How determined 65
    Not satisfactorily determinable, low or none 43
  Reorganizations subsequent to January 2, 1913 42
    Invested capital for prewar period 106

Corporations—*Continued.*	Paragraph
Reorganizations subsequent to March 3, 1917	107
Return	178
Liability to make	11
Parent, holding, and affiliated companies	183, 185
Subsidiaries	183, 185
Specific deduction	26
Subsidiaries	183, 185
Surplus. (*See* "Surplus in relation to invested capital.")	
Tax—	
Assessment and collection of	186
Liability to pay	11
Parent, subsidiary, and affiliated companies	183, 185
Rates	26, 27
Taxable year	5
Trade or business defined	7
All trades or businesses considered as one	24
Undivided profits. (*See* "Undivided profits in relation to invested capital.")	
Corrections required on annual balance sheet of corporations and partnerships	117
Invested capital determined on basis of balance sheet as corrected	129
Current liabilities in relation to invested capital	99
Deduction; computation of	38
Exceeding 15 per cent of capital	30
In case of invested capital satisfactorily determinable	38
Citizen or resident individuals	40
More than one trade or business	168
Domestic corporations	39
Domestic partnerships	40
Foreign corporations	41
Foreign partnerships	41
Nonresident aliens	41
More than one trade or business	168
In case of invested capital not satisfactorily determinable	5
Prewar period income being undeterminable satisfactorily; low; or none	43
Reorganizations subsequent to January 2, 1913	42
Deduction, specific:	
Citizens or residents	26, 40
Domestic corporations	26, 39
Domestic partnerships	26, 40

Deduction, specific:—*Continued.*	Paragraph
Foreign corporations; none	26
Foreign partnerships; none	26
Nonresident aliens; none	26
Definitions	1
Assets and liabilities in connection with invested capital of individuals	169
Corporation	2
Dividend	10
"Domestic"	3
"Foreign"	3
Intangible property	103
Money or other property borrowed	100
Nominal capital	170, 174
"Prewar period"	6
Tangible property	104
Taxable year	5
"Trade" or "business"—	
Corporations and partnerships	7
Individuals	8
"United States"	4
Depletion in relation to invested capital	93
Adjustment of, in connection with surplus	149, 155
Correction necessary on annual balance sheet	127
Depreciation in relation to invested capital	93, 115
Adjustment of, in connection with surplus	149, 155
Correction on annual balance sheet	127
Development of good will, trade marks, etc., charged to current expense; no readjustment permitted	152, 155
Devises; value of, is exempt from tax	58
Distributive interests of partnerships not taxable to members of partnerships	91
Dividend defined	10
Dividends deductible:	
Individuals	81
Corporations	64, 68
Partnerships	70, 72
Dividends received from foreign corporation which is subject to income tax	62, 82, 102
Domestic corporation defined (*see* also "Corporations")	3
Equipment originally charged as expense; readjustment of surplus account	151
Estimated capital invested	33

	Paragraph
Examples of tax computations. (*See* "Illustrations.")	
Exceptional cases; invested capital	109
Exceptional profits because of the war; bearing on invested capital	175
Exempt from tax liability	17
Exempt income	57
Exemption; specific. (*See* "Deduction; specific.")	
Expense involved in securing data for computation of invested capital by foreign taxpayers unreasonable in view of amount of tax	111
Expenses in relation to invested capital	93
Adjustment of book records in connection with surplus	149
Fees. (*See* "Salaries.")	
Fiscal year:	
First return for less than 12 months' period	37
Invested capital not satisfactorily determinable	35, 55
Partially falling within 1916	36
Relation to taxable year	5
Fixtures originally charged as expense; readjustment of surplus account	151
Foreign corporation stock in relation to invested capital	102, 129
Foreign corporations:	
Deduction; computation of	61
Definition of	3
Income from sources within the United States taxable	61
Invested capital of; specifically	105, 111
Return	178
Liability to make	12
Specific deduction; none	26
Tax; assessment and collection of	186
Liability to pay	12
Foreign dividends	62, 82, 102
Foreign partnership:	
Deduction; computation of	41
Income from sources within the United States taxable	61
Invested capital of; specifically	105, 111
Return	178
Liability to make	14
Salaries of members	75
Specific deduction	26
Tax; assessment and collection of	186
Liability to pay	14
Franchises. (*See also* "Intangible property.")	103
Furniture originally charged as expense; readjustment of surplus account	151

Paragraph

Gifts made; deductibility of by individuals..... 84
Gifts of tangible property; value of may be included as surplus... 146
Gifts; value of, is exempt from tax..... 58
Good will (*see* "Intangible property").....103, 124, 152
Government bonds in relation to invested capital.....98, 129, 146
Government bonds; interest from:
Issued prior to September 24, 1917, is exempt from tax..... 58
Issued subsequent to September 24, 1917, taxability of:
Corporations..... 64
Partnerships..... 69
Hawaii considered as domestic..... 3
Hawaii considered part of United States..... 4
Holding companies.....183, 185
Illustrations in computation of tax:
Corporations..... 28
When deductions exceed 15 per cent of invested capital.. 31
Individuals; one or more trades or businesses with invested capital with salary in addition..... 83, 89
Individuals and partnerships; trade or business with invested capital..... 29
When deduction exceeds 15 per cent of invested capital.. 32
Income disproportionate to invested capital..... 113
Income during prewar period:
How determined—
Corporations..... 65
Individuals..... 85
Partnerships..... 72
Not satisfactorily determinable; low; or none..... 43
Return of, not required when..... 178
Income exempt..... 57
Income for taxable year, how determined:
Corporations..... 64
Individuals..... 79, 80
Partnerships..... 69
Income subject to tax, generally..... 21
Class A: No invested capital or nominal capital merely..... 22
Class B: Invested capital..... 23
Indebtedness, bonded, versus capitalization; bearing on invested capital..... 177
Indebtedness, evidences of construed to be tangible property..... 104
Indebtedness in relation to invested capital..... 99
Adjustment of annual balance sheet..... 122

Individuals:	Paragraph
Accounting records	166
Books not kept	167
Books of account	166
Not kept	167
Change of ownership of business	42, 107
Deduction; computation of	40
Exempt to extent engaged in certain businesses or occupations	20, 60
Gifts made by; deductibility of	84
Government bonds; interest on	9, 58, 82
Income taxable—	
Classification of	21
How determined when there is invested capital	80
How determined when there is no invested capital or nominal capital merely	79
Intangible property; valuation of, in connection with invested capital	164
Invested capital; how measured	158
Rule for computing	166
Invested capital not satisfactorily determinable	51
Returns in such cases	56
Investments merely; profits from	9
Isolated, incidental and infrequent transactions	9
Married woman may make separate return	182
Nonresident aliens. (*See* "Nonresident aliens.")	
Partnerships; members of—	
Distributive interests	91
Salaries received from partnership	76, 92
Prewar income—	
How determined when there is invested capital	85
Not satisfactorily determinable; low; or none	43
Profits earned during taxable year and retained in trade or business	165
Reorganizations subsequent to January 2, 1913	42
Reorganizations subsequent to March 3, 1917	107
Returns	178
Liability to make	15
Rule for computing invested capital	166
Salaries considered income from trade or business having no invested capital or nominal capital merely	22, 79
Salaries paid to members of partnerships by the firm	76, 92
Salaries paid to selves	86
Prewar period	90

Individuals—*Continued.*	Paragraph
Salaries paid to members of partnerships by the firm	76, 92
Salaries paid to selves by individuals	86
Prewar period	90
Specific deduction	26, 40
Tangible property; valuation of, in connection with invested capital	159
Tax; assessment and collection of	186
Liability to pay	16
Taxable year for individuals	5
Trade or business:	
Defined	8
Different businesses separately taxed according to classification of income	25
More than one trade or business	168
Insurance companies; invested capital of	156
Intangible property:	
Appreciation in value of; correction of annual balance sheet	126
Appreciation in value through development; relation to invested capital	177
Defined	103
Development of, having been charged as current expense	152, 155
Valuation of, as invested capital of an individual	164
Valuation of, when purchased with cash or tangible property	144
Correction of annual balance sheet	124
No adjustment of, on account of surplus account	152, 155
Payment for, in stock or bonds not considered as payment in cash or tangible property	104
Valuation of, when purchased with stock or shares:	
Application of the 20 per cent limitation	138
Correction of annual balance sheet	117
Mixed tangibles, intangibles, patents, and copyrights	140
Nonpar value stock	139
Prior to March 3, 1917	137
Interest on loans to partnership by members thereof	77
Interest on obligations of State and political subdivisions thereof is exempt from tax	58
Interest on obligations of United States:	
Issued prior to September 24, 1917: Exempt from tax	58
Issued subsequent to September 24, 1917: Taxability of:	
Corporations	64
Individuals	82
Partnerships	69

Paragraph

Invested capital 93
Accounting; defective 110, 149, 155
Accounting; ultraconservative 111
Adjustment of annual balance sheet 117
Agents and brokers; nominal capital 173
Amortization 115
Appreciation in value of capital assets 93, 126, 177
Tangible property acquired prior to January 1, 1914 134
Averaging by months 94
Balance sheet required annually from corporations and partnerships 131
Corrections necessary 117
Invested capital determined on basis of balance sheet as corrected 129
Bonds in relation to invested capital 98, 101, 177
Surplus or undivided profits invested in 146
Tangible and intangible property; bonds issued for mixed aggregate of 140
Businesses which will not be deemed to have nominal capital 174
Capital versus invested capital 112, 172, 174
Capital assets; appreciation in value of 93, 126, 177
Tangible property acquired prior to January 1, 1914 134
Capitalization small or negligible; bearing on invested capital 174
Commission houses and merchants 173
Computation of, rule—
Corporations and partnerships 116
Individuals 166
Copyrights; valuation of when paid for in stock or shares 136
Correction of annual balance sheet 118, 119
Correction of annual balance sheet 117
Defined as invested capital of present owner 93
Depletion of property 93
Adjustment of, in connection with surplus 149, 155
Depreciation of property 93, 115
Adjustment of, in connection with surplus 149, 155
Exceptional cases 109
Expense involved in securing data for computation of invested capital in case of foreign taxpayers unreasonable in view of amount of tax 111
Expenses incurred 93
Adjustment of, in connection with surplus 149, 155
Foreign corporation stock 102, 129

Invested capital—*Continued.* Paragraph
Foreign corporations specifically....105, 111
Foreign partnerships specifically....105, 111
Good will.... 152
Correction of annual balance sheet.... 124
Is intangible property.... 103
Income disproportionate to invested capital.... 113
Indebtedness.... 99
Individuals specifically.... 158
Rule for computing.... 166
Insurance companies.... 156
Intangible property:
Appreciation in value of, because of development, etc....126, 177
Correction of annual balance sheet.... 117
Defined.... 103
Valuation when paid for in cash or tangibles.... 144
Payment in stock or bonds not considered payment in cash or tangible property.... 104
Valuation when paid for in stock or shares.... 137
Mixed tangibles, intangibles, patents, etc.... 140
Nonpar value stock.... 139
Intangible property; valuation of as invested capital of an individual.... 164
Items not allowed to be included.... 97
Liquidation of original capital.... 93
Losses sustained.... 93
Adjustment of, in connection with surplus....149, 155
Mixed aggregate of tangible and intangible property and patents and copyrights when paid for in stock or shares (or stock or shares and bonds or other obligations).... 140
Correction of annual balance sheet.... 118
Money or other money borrowed not to be included.... 99
The term defined.... 100
Mutual insurance companies.... 156
No invested capital (*see* "Nominal capital").
Nominal capital (*see* "Nominal capital").
Nonpar value stock; purchase of intangible property therewith. 139
Nonresident aliens specifically....105, 111
Not satisfactorily determinable....33, 51, 109
Fiscal year basis.... 35, 55
Returns in such cases.... 57
Obsolescence of property.... 93, 115
Adjustment of in connection with surplus....149, 150

Invested Capital—*Continued.* Paragraph
Paid in surplus....116, 147
Patents and copyrights; valuation of when paid for in stock or shares.... 136
Correction of annual balance sheet....118, 119
Prewar period.... 108
Profits earned during taxable year in case of an individual.... 165
Profits; exceptional because of war conditions; bearing on invested capital.... 175
Reorganizations subsequent to:
January 2, 1913.... 106
March 3, 1917.... 107
Return of for prewar period not required; when.... 178
Return of for taxable year.... 181
Stock issued or exchanged for property, returned to corporation as gift or for consideration considerably less than par.... 132
Correction of annual balance sheet.... 121
Stock insurance companies.... 157
Stocks and bonds in relation to invested capital....98, 101, 129, 177
Foreign corporation stock.... 102, 129
Surplus or undivided profits invested in.... 146
Surplus in relation to invested capital....93, 116, 146
Earned during any prewar year.... 145
Earned during taxable year.... 145
Investment in securities, tax-free and otherwise.... 146
Paid-in surplus....116, 147
Readjustment of surplus account....149, 155
Tangible property considered as surplus when.... 147
Tangible property considered as surplus when.... 147
Tangible property; items construed to be.... 104
Valuation when paid for in stock or shares.... 134
Correction of annual balance sheet.... 118
Mixed tangibles, intangibles, patents, etc.... 140
Tangible property valuation of, as invested capital of an individual.... 159
Tax-free securities....98, 101, 129, 177
Surplus or undivided profits invested in.... 146
Trade or business having invested capital. (*See* "Invested capital, trade or business having.")
Undivided profits in relation to invested capital....93, 116, 146
Earned during any prewar year.... 145
Earned during taxable year.... 145
Invested in securities, tax-free and otherwise.... 146

Invested capital—*Continued.*
Undivided profits, etc.—*Continued.* Paragraph
Paid in surplus 147
Readjustment of surplus account 149, 155
Tangible property considered as surplus when 147
Invested capital—trade or business having
Constructive capital for application of rates deduction, computation of 38
Tax rates 27
Invested capital versus capital 172, 174
Investment of surplus in securities, tax-free and otherwise 146
Investments merely; profits from two individuals 9
January 2, 1913; reorganizations subsequent to 42
Invested capital for prewar period 106
January 1, 1914; tangible property paid in for stock or shares:
Prior to this date 134
Appreciation in value of assets allowed 134
Subsequent to this date 135
Judges of United States; salary of, is exempt from tax 58, 60
Leaseholds construed to be tangible property 104
Life insurance; proceeds are exempt from tax 58
Limited partnership considered a corporation 2
Loans to partnership by members thereof; interest on:
Taxable year 77
Prewar period 78
Losses in connection with invested capital 93
Adjustment of books in connection with surplus 149
March 3, 1917; intangible property purchased with stock or shares prior to 137
Application of the 20 per cent limitation 138
Non-par-value stock 139
March 3, 1917; mixed property (tangible or intangible) purchased with stock or shares 140
March 3, 1917; reorganizations subsequent to; invested capital 107
Married woman may make separate return 182
Mixed aggregate of tangibles, intangibles, patents, and copyrights purchased with or paid for in stock or shares (or stock or shares and bonds or other obligations); valuation of 140
Correction of annual balance sheet 118
Money or other property borrowed not to be included in invested capital 99
The term defined 100
Mutual insurance companies, invested capital of 156

	Paragraph
Net income subject to tax; classification of	21
Class A: No invested capital or nominal capital merely	22
Class B: Invested capital	23
Net income subject to tax; how determined:	
Corporations	64
Individuals	79, 80
Nonresident aliens	79, 80
Partnerships	69
Nominal or no invested capital	170
Agents and brokers	173
Businesses which will not be deemed to have nominal capital	174
Commission houses and merchants	173
Large capital does not preclude nominal invested capital	172
Personal service, occupation, profession, trade, and business	170
Salaries, wages, fees, etc., of individuals	22, 79
Tax rates	26
Nonpar value stock in connection with purchase of intangible property with stock	139
Nonresident aliens (*see* "Individuals" for general provisions):	
Deduction; computation of	41
Income from sources within the United States taxable	61, 79, 80
Income of, subject to tax; how determined	79, 80
Invested capital of, specifically	105
Return	178
Liability to make	16
Salaries paid to selves	87
Specific deduction; none	36
Tax; assessment and collection of	186
Liability to pay	16
Notes construed to be tangible property	104
Obsolescence of property in relation to invested capital	93, 115
Correction of annual balance sheet	127
Adjustment of in connection with surplus	149
Occupations involving personal service	170
Organizations subsequent to January 2, 1913, which are substantially a continuation of a former business	42
Invested capital for prewar period	106
Correction of annual balance sheet	125
Original capital, liquidation of	93
Ownership of property, income arising merely because of	9
Paid-in surplus	116, 147

	Paragraph
Parent corporations	183, 185
Partial year, return and payment of tax for	37
Partnerships:	
Balance sheet required annually on last day of taxable year	131
Corrections required	117
Invested capital determined on basis of balance sheet as corrected	129
Deduction, computation of	40
Distributive interests not taxable to members	91
Dividends deductible	70, 72
Exempt partnerships	19
Fiscal year	5
Less than 12 months' period	37
Partially within 1916	36
Foreign partnerships; return and tax liability	14
Specific deduction; none	26
Income taxable:	
Classification of	21
How determined for prewar period	72
How determined for taxable year	69
Interest on loans by members to the firm	77
Invested capital not satisfactorily determinable	51
Fiscal year basis	55
Returns in such cases	56
Invested capital	93
Rule for computing (*see also* "Invested capital")	116
Investment of surplus in securities, tax-free and otherwise	146
Limited partnerships considered as corporations q. v.	2
Nominal capital. (*See* "Nominal capital.")	
Prewar income—	
How determined	72
Not satisfactorily determinable; low; or none	43
Salaries of, and interest paid to, members	78
Reorganizations subsequent to—	
January 2, 1913	106
March 3, 1917	107
Returns	178
Liability to make	13
Salaries of members—	
Deductible by firm	71, 73
Prewar period	78
Taxable to members	76, 92

Partnerships—*Continued.*	Paragraph
Specific deduction	26, 40
Tax, assessment and collection of	186
Liability to pay	13
Taxable year	5
Income of, how determined	69
Trade or business—	
All trades or businesses considered as one	24
Defined	7
Patents and copyrights paid in for stock or shares; valuation of	136
Correction of annual balance sheet	118, 119
Mixed tangibles, intangibles, patents, and copyrights	140
Patterns originally charged to expense; readjustment of surplus account	151, 153, 155
Personal service occupations, professions, trades, and businesses, nominal capital	170
Plant expenditures charged originally to expense; readjustment of surplus account	151
President of United States, salary of, is exempt from tax	58, 60
Prewar period:	
Defined	6
Income of, how determined—	
Corporations	65
Individuals when there is invested capital	85
Salaries paid to selves	90
Partnerships	72
Salaries of, and interest paid to, members	78, 91
Income not determinable satisfactorily; low; or none during prewar period	145
Invested capital, manner of determining	108
Surplus earned during any prewar year	145
Professions; nominal capital	170
Profits earned during taxable year and retained in business in case of individuals (*see* "Undivided profits" for corporations and partnerships)	165
Profits, exceptional because of war conditions; bearing on invested capital	175
Promissory notes construed to be tangible property	104
Reorganizations since January 2, 1913	42
Correction of annual balance sheet	125
Invested capital for prewar period	106
Reorganization since March 3, 1917; invested capital	107
Correction of annual balance sheet	125

	Paragraph
Returns	178
Consolidated return	185
Fiscal year	5
Less than the regular 12 months' period	37
Partially falling within 1916	36
Holding companies	183, 185
Invested capital not satisfactorily determinable; returns in such cases	56
Liability to make return—	
Citizens and residents	15
Domestic corporations	11
Domestic partnerships	13
Foreign corporations	12
Foreign partnerships	14
Nonresident aliens	16
Married woman may make separate return	182
Parent corporations	183, 185
Period covered	5, 37
Statement of proposed additions to surplus on account of readjustments to be included on return	154
Subsidiaries	183, 185
Taxable year	5
Fiscal year partially falling within 1916	36
Less than the regular 12 months' period	37
Rule for computing invested capital:	
Corporations and partnerships	116
Individuals	166
Salaries considered income from trade or business having no invested capital or nominal capital only	22, 79
Exempt salaries	58, 60
Minimum amounts received as salaries taxable	26, 40
Partnerships; salaries of members of	76, 92
Self, salary paid to	88
United States, State, etc., employees	60
Salaries paid members of partnership by the firm:	
Deductible by firm	71, 73
Foreign partnerships	75
Prewar period	78
Taxable to members	76, 92
Salary paid to self	86
Nonresident aliens	87
Prewar period	90

Paragraph
Securities in relation to invested capital....98, 101, 129, 177
Foreign corporation stock....102, 129
Surplus or undivided profits invested in securities, tax-free and otherwise.... 146
Tangible property; securities construed to be.... 104
Services; occupations, professions, trades, businesses, involving personal service; nominal capital.... 170
Specific exemption or deduction. (*See* "Deduction, specific.")
State, etc., employees; salaries of, are exempt from tax.... 60
State obligations; interest on, is exempt from tax (*see also* "Tax-free securities").... 58
Stock or shares issued or exchanged for property:
Correction of annual balance sheet in connection with.... 117ff
Intangible property, valuation of.... 137
Application of 20 per cent limitation.... 138
Nonpar value stock.... 139
Payment made in stock not considered as payment made in cash or tangible property.... 104
Mixed tangibles, intangibles, patents, and copyrights.... 140
Patents and copyrights; valuation of.... 136
Stock returned to corporation as gift or for consideration considerably less than par.... 119
Tangible property; valuation of.... 134
Stock insurance companies; invested capital of.... 157
Stock without par value; purchase of intangible property therewith 139
Stocks and bonds in relation to invested capital....98, 101, 129, 177
Foreign corporation stock....102, 129
Government bonds.... 98, 146
Surplus or undivided profits invested in securities, tax-free and otherwise.... 98, 146
Tangible property; stocks and bonds construed to be.... 104
Subsidiaries....183, 185
Subtractions on annual balance sheet in computing "invested capital".... 117
Surplus in relation to invested capital....93, 116, 146
Earned during taxable year.... 145
Earned during any prewar year.... 145
Government bonds; investments in.... 98, 146
Individuals; profits earned during taxable year and retained in business.... 164
Invested in tax-free and other securities.... 98, 146
Paid-in surplus....116, 147

Surplus in relation to invested capital—*Continued.* Paragraph
Readjustment of surplus account....149, 155
Tangible property—
Cost of, originally charged to expense; readjustment of surplus account....151, 153, 155
When to be included as surplus.... 147
Tangible property:
Appreciation in value of; correction of annual balance sheet.. 126
Cost of, originally charged to expense; readjustment of surplus account....151, 153, 155
Intangibles purchased with.... 144
Items construed to be.... 104
Purchased for nominal sum; excess of value over purchase price may be included as surplus.... 147
Surplus; when tangible property may be included as.... 147
Valuation of, as invested capital of individual.... 159
Valuation of, when purchased with stock or shares—
Correction of annual balance sheet.... 118ff
Mixed aggregate of tangibles, intangibles, patents, and copyrights.... 140
Prior to January 1, 1914.... 134
Subsequent to January 1, 1914.... 135
Tax; assessment and collection of.... 186
Parent, subsidiary, and affiliated companies....183, 185
Tax; computation of.... 21
Constructive capital invested.... 33
Deduction exceeding 15 per cent of capital invested.... 30
Fiscal year partially within 1916.... 36
Illustrations—
Corporations.... 28
When deduction exceeds 15 per cent of invested capital 31
Individuals and partnerships; trade or business with invested capital.... 29
When deduction exceeds 15 per cent of invested capital 32
Individuals; one or more trades or businesses with invested capital with salary in addition.... 83, 89
In case of invested capital.... 27
In case of no invested capital or nominal capital merely.... 26
Less than 12 months' period.... 37
Tax-free securities....98, 101, 129, 177
Surplus or undivided profits invested in.... 146
Tax liability.... 11
Citizens and residents.... 15